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PROPOSED MODIFICATIONS TO THE AT&T DECREE

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST,
MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE JUSTICE DEPARTMENT'S PROPOSAL TO LIFT THE LINE OF BUSINESS RESTRICTIONS CONTAINED IN THE AT&T CONSENT DECREE

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PROPOSED MODIFICATIONS TO THE AT&T DECREE

THURSDAY, APRIL 30, 1987

U.S. Senate,
Subcommittee on Antitrust,
Monopolies and Business Rights,
Committee on the Judiciary,
Washington, DC.

The subcommittee met at 9:38 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senators Heflin, Thurmond, and Hatch.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator Metzenbaum. The committee will come to order.

The breakup of AT&T created a revolution in our Nation's telephone system. The good news is that the competition is reducing rates and fostering new technologies in long distance and other telecommunication services.

The bad news, and it is very bad, is that monthly telephone rates have shot up and service has gone down. In my own State of Ohio, the average monthly local telephone bill has risen nearly 40 percent. Ratepayers are beset with unintelligible bills, a multiplicity of bills, confusing choices, and other nuisances. They want, and they deserve, good service and reasonable rates. We have made a major step backward.

Now, the Justice Department, three short years after the breakup, is proposing another round of radical change in the system, change that could drive rates up and bring service down even further, change that could nip competition in the bud.

Now, in February, the Department said it wanted to let the Bell Operating Companies provide long distance, manufacturing and information services, areas deemed off bounds to them under the 1982 AT&T consent decree because of the potential for abuse of their local telephone monopolies.

Fear of such abuse was the cornerstone of the AT&T case. The Government showed that AT&T used its local telephone monopoly to monopolize long distance and manufacturing, that regulators were powerless to control it, and that divestiture was the only effective remedy.

In my own mind, I am not certain whether the remedy was not worse than the illness itself.

But since the Baby Bells would have the same incentives to abuse their monopoly that AT&T had, they were barred by the decree from providing long distance, manufacturing and information services.

As late as September 1985, the Assistant Attorney General for Antitrust told Congress that the restrictions were still required.

Now, in a virtually overnight reversal, the Department of Justice has recommended that the restrictions be drastically weakened, even though the Baby Bells still have their monopolies. In a startling contradiction of its own past position, it now says regulation will prevent abuse.

The Department's position could allow the abuses that led to the AT&T case in the first place—charging the ratepayer for the purchase of the most expensive equipment, using cross-subsidies and monopoly control of the local network to keep competitors out, and on and on and on.

And then this past Monday, the Department seemed to flip-flop yet again. By backing away from its February recommendation to relax the long distance restriction, this latest reversal suggests the Department may now be as confused as I am by all its twists and turns on this issue. The Department has flipped-flopped; now they flop-flip.

I will listen carefully to what Mr. Rule from Justice and our other distinguished witnesses have to say about the Department's recommendations. But, as I see it, and as the decree itself contemplates, the burden of proof is on those seeking to lift the restrictions to demonstrate that doing so is in the best interests of the local ratepayer and of competition in the telecommunications industry.

We have a longer list of witnesses than the Chair would normally like to schedule for a hearing of this kind. But there were so many who were so anxious to be heard, that we have put them on the list. We have four separate panels. We will allow 10 minutes to Mr. Rule, and a strict 5-minute rule with respect to each of the other witnesses.

Mr. Rule, we are happy to welcome you again to this committee.

[The Statements of Senators Simon, Hatch, and Thurmond follow:]

PREPARED STATEMENT OF SENATOR PAUL SIMON

Mr. Chairman, I want to congratulate you for taking the initiative to hold a hearing on the Justice Department's proposal to lift the line of business restrictions contained in the AT&T Consent Decree. I look forward to reviewing the transcript of this hearing and the written statements of today's witnesses, who are here to update the Subcommittee on a most complex and confusing set of issues.

I opposed the breakup of AT&T at the time because I felt that a regulated monopoly offered the public better service at lower cost than a plurality of largely unregulated, diversified businesses. Admittedly, the AT&T divestiture had had some significant positive effects. Vigorous competition for long distance service has caused rates to drop and consumers now enjoy wider choices in telecommunications products and services. At the same time, however, this restructuring has meant higher local rates, confusing bills, and sometimes less than satisfactory equipment—among a variety of other annoyances. The AT&T Consent Decree was designed to prevent the Regional Holding Companies from abusing the same "bottleneck monopolies" that were the catalyst for the breakup of AT&T in the first place. Despite some problems, I think the Decree has served this purpose well.

I am concerned that dismantling the Decree's protections to allow a wholesale diversification by the Regional Holding Companies into the long distance, information, manufacturing and unrelated telecommunications business will do more harm than good to American consumers. If there is to be a second restructuring of the telecommunications business, I believe it should evolve in a deliberate, cautious manner, with every step tailored to ensure that the public's telephone service improves in both quality and price.

I feel, however, that the Justice Department's proposals and the triennial study of competitive changes in the industry on which it is based, merit serious consideration. While I think we plainly need to avoid a headlong rush to diversification, I will review the Justice Department's claim that significant technological, structural and economic changes justify a relaxation of the line of business restrictions with an open mind.

In any case, Congress should await the Court's response to the Justice Department's proposals before taking action in this area. Should Congressional action become necessary, we must be sure that such action does not divert the Regional Holding Companies from their most important responsibility—providing low-cost, high quality telephone service to every American who wants it.

PREPARED STATEMENT OF SENATOR ORRIN G. HATCH

Mr. Chairman, I commend you for holding hearings this morning on the Justice Department's recommendations concerning the line-of-business restrictions imposed on the Bell Operating Companies by the 1982 consent decree. This is a critical issue for the regional telephone companies and it is important and appropriate for the Antitrust Subcommittee to examine carefully the issues both in defense and in opposition to the proposed modifications within the consent decree.

In accordance with the obligations dictated by Judge Greene, the Justice Department has reviewed changes and filed a report as to the competitive conditions in the telecommunications industry on the third anniversary of divestiture. The Justice Department has concluded that there is no longer a need for the decree prohibitions of Bell Operating Company involvement in the areas of: information services; manufacturing and providing of equipment; and nontelecommunications businesses.

It is important for us to note that the original divestiture and prohibitions imposed by the consent decree resulted in a significant loss of jobs in many regions of the United States. Since divestiture, Mountain Bell in Utah has eliminated almost five-hundred jobs, employees that might otherwise have been employed to provide information services, or to participate in nontelecommunications business. While we must continue to guard against using existing local exchange bottlenecks to impede competition, we must also examine in what respects retention of the current line-of-business restrictions impedes increased competition, thereby injuring consumers.

I recognize the importance of the questions before us today and I look forward to hearing the testimony of these knowledgeable witnesses.

PREPARED STATEMENT OF SENATOR STROM THURMOND

Mr. Chairman, substantial changes are taking place in the telecommunications industry, as we are all aware. The AT & T consent decree changed the structure of the industry in ways that are still unfolding.

This whole area is a very complex one which has remained under the watchful supervision of the presiding judge in the AT & T case and the Justice Department; these policy issues are also followed by the Federal Communications Commission and a subcommittee of the Senate Commerce Committee.

At this very moment, there are significant issues pending before the presiding judge. The Justice Department and the various interested parties in the matter are presenting their views to the Court on many complicated questions of fact.

In light of the status of the matter, I would express caution about the role of these hearings. Since the various motions and recommendations are pending before the Judge as an adjudicative matter, I for one would regard it as inappropriate to take a position or express a preference on the pending issues.

Thank you, Mr. Chairman.

STATEMENT OF CHARLES RULE, ACTING ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. Rule. Thank you, Mr. Chairman.

I understand that the members of the Subcommittee have been provided with a copy of my remarks and so I will just summarize those this morning.

I appreciate the opportunity to be here with you this morning to explain the recommendations that the Department, on behalf of the United States, recently made concerning the line-of-business restrictions imposed on the Bell Operating Companies, what I will call the BOCs this morning, by the 1982 consent decree entered in the Government's antitrust case against AT&T.

The line-of-business restrictions prohibit the Bell Operating Companies, the BOCs, from engaging in any business other than local telephone service and the provision of customer premises equipment and yellow pages.

I will not be discussing today the history of the *AT&T* case and the decree, matters with which I am sure the members of this Subcommittee are familiar. Moreover, because the matter is currently pending before Judge Greene, and because the Department is likely to make additional filings before the Judge issues his decision, I will limit myself this morning to discussing the public filings concerning the possible modifications of the decree.

At the time Judge Greene entered the decree in 1982, he required that the Department undertake a study of the circumstances surrounding the decree and, every three years after divestiture of the BOCs from AT&T. On the basis of that study, we were to determine the extent to which the line-of-business restrictions remain necessary to protect competition in the markets from which the BOCs are excluded.

We were then to make recommendations concerning modifications of the decree to the Judge. It was that obligation we were fulfilling when we engaged Dr. Peter Huber to study the industry in 1985, and when, on February 2, 1987, we filed our report and recommendations with the court.

As the Subcommittee knows, the United States has recommended to the court that the MFJ decree be modified in order to remove most of its restrictions on BOC activities. Specifically, we have recommended the lifting of the prohibitions of BOC involvement in information services, manufacturing and providing of telecommunications and customer premises equipment, and non-telecommunications businesses.

We have concluded that these restrictions are not necessary to protect competition, and that they may be impeding the efficient provision of new services to consumers.

In general, we have not recommended that the court remove the general decree prohibition on BOC provision of interchange services. We have recommended, however, that the BOCs be permitted to provide interexchange cellular paging and other mobile services. If the court accepts our recommendations, the BOCs would be able to seek waivers from the court for particular interexchange services under the standard of Section VIII(C) of the decree. That is, the BOCs would be allowed to provide particular interexchange services where they could show, on a case-by-case basis, there was no substantial possibility that they could use their monopoly power in the local exchange market to impede competition in the interexchange markets that they seek to enter.

Thus far, the court has indicated that it will not consider waivers to allow the BOCs to provide interexchange service. Our study of the industry has led us to believe, however, that under certain circumstances—for example, where the proposal involves interexchange service completely outside of a BOC's region—a BOC's proposal to provide interexchange service can meet the standard and should be granted.

Mr. Chairman, in your opening remarks, you referred to a flip-flop, and I would like to correct what I believe is a misperception as to what we did last Monday concerning our recommendations on the interexchange prohibition.

The Department has not changed its position concerning the circumstances under which, and the extent to which, the BOCs should be allowed into long-distance service. After carefully studying the 114 comments that were filed with the court concerning our February 2nd report and recommendations, the Department remains convinced that our view of where and when the BOCs can engage in long distance was correct. The question of how to implement that view was a complex one.

In our filing and proposed order of Monday, we recognized that the enforcement and line-drawing difficulties that would attend an effort to modify the decree in order to implement our recommendations would be extremely great. My prepared remarks provide an explanation of those difficulties.

Suffice it to say here, however, that we concluded the existing waiver process of the decree, which thus far has generally not been used for interexchange services, provides a much more efficacious and flexible means of accomplishing our long-distance objectives as explained in the February 2nd filing.

Let me very briefly, in the time I have, explain the reasons for our recommendations.

First, let me make it clear that they are based on the explicit standard that is in the decree, the one that Judge Greene put in, the one that the Government and AT&T agreed to when the decree was entered. That standard is the standard of VIII(C) of the decree, which provides that the BOCs can enter the prohibited markets when their entry does not threaten competition there.

We engaged in a long study, and our conclusions and our recommendations were based on lifting those restrictions where lifting of those restrictions could be consistent with that standard.

Judge Greene, at the time he adopted that standard, expressly rejected the Department's arguments—this was in 1982—that the line-of-business restrictions could not be lifted until the Bell Operating Companies' local telephone bottlenecks were gone. The decree's focus is on the markets the BOC's seek to enter, not on local telephone markets.

While correction of antitrust problems in competitive markets should be done in a way not to harm ratepayers, continuation of antitrust restrictions cannot be justified solely in order to protect ratepayers. That is up to Congress and the State legislators and up to the regulators.

Second, a lot has changed since the time the decree was entered. That was the basis of the Huber Report, which is rather lengthy, and the various filings we have made with the court. At the time the decree was entered, AT&T was the largest company in the world. It was virtually a monopolist in almost every domestic telecommunications market.

Today, the BOCs are not even one-eighth the size of the old AT&T, and they are no bigger—in fact, in many cases smaller—than many of the other competitors who are in these markets, competitors such as IBM, NEC, Siemens, and so forth. Not only do they not have a monopoly in these various unregulated competitive markets, they have zero market share. They are not even allowed in there because of the decree.

Second, equal access and the concepts of equal access and competition in telecommunications markets are now well accepted. That was not the case when the decree was entered, and certainly was not the case when AT&T engaged in the conduct that was the basis of the Government's suit.

The antitrust rules, we believe, are much clearer today, and we think that is beneficial. The BOCs should know that to the extent they participate in these markets, they will be bound by the same rules of competition that all other competitors are.

Third, competition has developed in many of the markets from which the Bell Operating Companies are currently excluded by the decree. For example, the equipment markets are thriving with numerous participants, many of which, as I have mentioned, are larger than the Bell Operating Companies. There is, in our opinion, no threat of domination by the BOCs of those markets.

Despite, for example, DOJ predictions in 1982 that even allowing the Bell Operating Companies to provide CPE would result in harm to the CPE market, there is no evidence that their ability to provide such equipment has in any way harmed the customer premises equipment market. They certainly are not dominant there.

Fourth, regulators by and large believe that they can regulate and control the diminished risk of cross subsidy that remains today.

As you know, at the time the *AT&T* decree was entered, the FCC essentially threw up its hands and said it was incapable of controlling that cross-subsidy. That is not its opinion today. The FCC can check one BOC against another, in looking at their cost plans and looking at how they treat competitors. Moreover, the ability of AT&T, and Siemens, and NEC and all these other large companies to monitor the activities of the BOC's and report that to the regulators provides a tremendous check on the BOCs abuse of ratepayers.

The FCC has adopted equal access rules across the board. Cost allocation rules are being developed. The regulatory agencies, in terms of relative competence, are much better able to make myriad accounting, engineering and regulatory decisions that are necessary.

Let me just, in conclusion, point out that our recommendations were based on that standard. It is also important, we think, for everyone to keep in mind that the restrictions, particularly in the area of information services, appear to be imposing a cost on this country in terms of the efficiency of our telecommunications network, and in terms of the services that are available to the small telephone users who can't afford their own private branch exchange or expensive equipment.

It is important to this country, it is important to telecommunications, it is important to the economy as a whole, that we not impede our efficiency and effectiveness by limiting the ability of these important companies to provide services to consumers.

Knowing my time is up, I will stop there and be happy to answer any questions, Mr. Chairman.

[Prepared statement and letters follow:]

STATEMENT OF

CHARLES F. RULE
ACTING ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, MONOPOLY AND BUSINESS RIGHTS
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to be here with you this morning to explain the recommendations that the Department, on behalf of the United States, recently made concerning the line-of-business restrictions imposed on the Bell Operating Companies ("BOCs") by the 1982 consent decree ("MFJ" or "decree") entered in the government's antitrust case against AT&T. 1/ I will not be discussing today the history of the AT&T case and the MFJ matters with which I am sure the members of the Subcommittee are faimiliar. Moreover, because the matter is currently pending before Judge Greene and because the Department may make additional filings before the judge issues his decision, I will limit myself to discussing the public filings concerning the possible modifications of the decree.

As this Subcommittee knows, the United States has recommended to the Court that the MFJ be modified in order to remove most of its restrictions on BOC activities. Specifically, we have recommended lifting the prohibitions on BOC involvement in information services, manufacturing and providing of telecommunications equipment and customer premises equipment, and nontelecommunications businesses. We have concluded that these restrictions are not necessary to protect

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1/ United States v. American Tel. and Tel. Co., 552 F. Supp. 131 (D.D.C. 1982), aff'd mem. sub nom. Maryland v. United States, 460 U.S. 1001 (1983).

competition and that they may be impeding the efficient provision of new services to consumers.

In general, we have not recommended that the court remove the general decree prohibition on BOC provision of interexchange services. We have recommended, however, that the BOCs be permitted to provide interexchange cellular, paging, and other mobile services. If the Court accepts our recommendations, the BOCs would be able to seek waivers from the Court for particular interexchange services under the standard of section VIII(C) of the decree. That is, the BOCs could be allowed to provide particular interexchange services where they could show, on a case-by-case basis, that there was no substantial possibility that they could use their monopoly power in the local-exchange market to impede competition in the market they sought to enter. Thus far, the Court has indicated that it will not consider waivers to allow the BOCs to provide interexchange service. Our study of the industry has led us to believe that under certain circumstances - for example, where the proposal involves interexchange service completely outside a BOC's region - BOC proposals to provide interexchange service can meet that standard and should be granted waivers.

The Department's report and recommendations, and the report prepared for us by an independent consultant, Dr. Peter Huber, provided the factual basis for the recommended changes in the decree restrictions. 2/ These reports and recommendations were submitted to Judge Greene in fulfillment of our commitment to file a report with the Court on the third anniversary of divestiture concerning changes in competitive conditions in the industry. Specifically, we were to address whether there was a continuing need for the decree prohibitions on BOC involvement in businesses other than exchange telecommunications, exchange access, and the other limited types of services expressly authorized by the decree. 3/

2/ The Geodesic Network: 1987 Report on Competition in the Telephone Industry ("Huber Report").

3/ The MFJ specifically authorizes the BOCs to provide exchange telecommunications and exchange access service; to provide, but not to manufacture, customer premises equipment ("CPE"); and to produce and distribute "Yellow Pages" directories. MFJ Sections II(D)(3), VIII(A), (B); 552 F. Supp. at 228, 231.

These recommendations were based on careful consideration of the extent to which technological, economic, and regulatory developments that have occurred since the decree was entered have either eroded the monopoly power of the BOCs in local-exchange telecommunications or diminished the risk that the BOCs would use their control over the local exchanges to impede competition if permitted to enter particular markets foreclosed to them by the decree. In this regard, we found especially important the procompetitive effects that the decree has had in reducing the potential for the BOCs to abuse their control over the "bottleneck" and in stimulating competition in the telecommunications industry generally. We also considered the extent to which existing prohibitions on BOC entry, especially where they limit integration, currently limit competition or impair the efficient provision of services. Finally, we considered various regulations adopted by the Federal Communications Commission ("FCC") that are specifically designed to reduce the competitive risk of allowing BOC entry into competitive telecommunications markets without unduly sacrificing substantial efficiencies of integration. In this regard, we compared the relative institutional effectiveness of the FCC's administration of these regulations with judicially administered injunctions and waiver proceedings.

Our initial report, filed on February 2, 1987, recommended that the Court remove the decree prohibitions on BOC provision of information services, provision and manufacturing of telecommunications equipment and manufacturing of CPE, and involvement in nontelecommunications businesses. We found that because technical and competitive changes have substantially lessened the BOCs' incentives and abilities to engage in conduct that could impair competition in these markets, blanket prohibitions are no longer necessary to protect competition. Moreover, we concluded that the decree prohibitions -- especially the prohibition on information services -- may themselves impede competition and efficiency. Indeed, particularly with regard to information services -- for example, voice storage and retrieval, protocol conversion, and data-base services -- prohibiting the BOCs from competing may be denying many Americans the benefits of the information age. Moreover, the prohibitions threaten to impair this nation from taking full advantage of its historic strength in the area of telecommunications technology. The failure to have the most advanced and efficient telecommunications industry may well impair the efficiency and competitiveness of the entire economy.

In making these recommendations, we acknowledged that some risk of discrimination and cross-subsidization remains. We concluded, however, that the FCC's adoption of rules and procedures that embody the appropriate competitive standards make it unnecessary, and probably counterproductive, for the Department and the Court to continue a duplicative, time-consuming, and expensive waiver process with respect to these activities.

Consideration of the relevant competitive factors led us to a different initial recommendation concerning the decree's prohibition of BOC provisions of interexchange services, however. While the decree has made possible the efficient provision of long-distance services on an equal access basis, we concluded that the BOCs' continued control over legally-protected local-exchange monopolies might give them significant ability and incentive to impair competition in interexchange services originating or terminating in their regions. Accordingly, we recommended continuation of the MFJ's prohibition against BOC provision of interexchange telecommunications services that originate or terminate in any area where that BOC has a legally-protected local-exchange monopoly.

We suggested, however, that a BOC would have no significant ability to abuse a legally-protected bottleneck to impair competition in interexchange services entirely outside of its region. We thus initially suggested that the decree restriction could be modified to permit such services. We further recommended that if, in the future, a BOC were able to show that all regulatory barriers to entry and resale in exchange telecommunications service had been removed in particular exchange areas within its region, that BOC should be allowed to provide interexchange services among such competitive exchange areas, or among one or more such exchange areas and any points outside of that BOC's region.

In submitting the United States' initial recommendations, we explicitly acknowledged that any proposal for removal of the decree's restrictions presented difficult and close questions. Thus, we suggested that the Court invite public comment on our recommendations. We also expressly reserved the right to modify them before asking the Court to change the decree restrictions.

On February 4, 1987, the Court entered an order permitting interested persons to intervene in order to file comments on our recommendations. Approximately 150 persons and entities were granted limited intervenor status, and 114 sets of comments were filed with the Court. In addition to AT&T and the BOCs, the commenters included interexchange carriers, information service providers, equipment manufacturers and distributors, the FCC, state regulatory agencies, and organizations representing users of telecommunications services.

There was considerable diversity in the views presented by the commenters. Not surprisingly, the BOCs supported our recommendations for removal of the restrictions, but they contended that the interexchange services recommendation did not go far enough. AT&T did not oppose some changes in the information services and nontelecommunications restrictions, although it did not want the Court to eliminate them entirely. Not surprisingly, however, AT&T and various limited intervenors opposed removal of restrictions that would allow the BOCs to compete with them in additional markets.

The FCC and the state regulatory authorities that filed comments generally favored lifting the decree restrictions -- especially the information services prohibition. The states, however, were concerned that any action by the Court not infringe on their regulatory powers. Indeed, some states asked the Court to impose conditions giving them additional control over BOC activities. Significantly, only a few commenters questioned any of the factual findings of the Huber Report, and none identified any errors that undercut Dr. Huber's conclusions or the Department's recommendations.

The Department carefully considered all of the comments. On April 27, we responded to those comments and filed a motion for partial removal of the line-of-business restrictions. That motion does not represent a change in our view of the lines of business from which the BOCs should or should not be excluded. The motion does reflect, however, our reassessment of how best to implement our initial recommendations.

We concluded that no changes were required in our initial information services, equipment, and nontelecommunications businesses recommendations. Therefore, we have asked the Court to remove the decree restrictions on BOC participation in those activities. We also asked the Court expressly to condition removal of those restrictions on application of the nondiscrimination provisions of the decree to prohibit discrimination by a BOC that would favor the BOC's competitive businesses over any of its competitors in interconnection and dissemination of technical information and interconnection standards. Because review under the decree of the BOCs' procurement decisions is not necessary to protect competition, however, we asked the Court to remove the decree prohibition on procurement discrimination.

Our response to the comments also reaffirmed our belief in the conceptual soundness of our initial position concerning interexchange services, and our analytical disagreement with many of the arguments made by critics of that proposal. We were not persuaded by the BOCs' contentions that, despite the persistence of their local exchange bottlenecks, the potential for anticompetitive conduct has been sufficiently reduced so as to justify modification of the decree restrictions to allow the BOCs to provide interexchange services within their regions. Nor were we persuaded by those who argued that BOC entry in interexchange service solely outside of their franchised monopoly areas, viewed by itself, was a cause for serious competitive concern. Rather, we continue to believe that a BOC would be unlikely to impair competition if it were allowed to provide interexchange service entirely outside of its region.

As we recognized when we made our original recommendations, however, there would be substantial practical problems in implementing what we believe to be a conceptually sound distinction between interexchange services that originate or terminate in a BOC's monopoly franchise areas and those that do not. It would be difficult in a general order to define the technical and business limitations of "out-of-region" interexchange service in a way that would provide the kind of clear, enforceable, procompetitive distinction we are seeking.

Moreover, it does not appear that any significant efficiencies or other benefits to consumers would result from allowing the BOCs to provide out-of-region interexchange services. Indeed, the BOCs' comments on our initial recommendation did not indicate much enthusiasm for a strictly-limited, out-of-region exception to the interexchange services prohibition. In these circumstances, we concluded that we could more effectively implement our recommendation to allow the BOCs into purely out-of-region interexchange services on a case-by-case basis, utilizing the existing waiver process in the decree.

Our response also stated that we remain convinced that governmental restrictions on competition within local exchange areas are the primary reason for the remaining potential for anticompetitive discrimination or cross-subsidization. Therefore, if such restrictions are removed, the decree prohibition would no longer be necessary even for "in-region" interexchange services.

As we indicated to the Court in our initial filing, however, it is difficult to specify in advance the precise changes in state regulatory restrictions that would be necessary to eliminate any practical risk of anticompetitive abuse of a local exchange "bottleneck" and thus satisfy the decree standard. The absence of constructive suggestions in the comments on this point led us to conclude that it would be premature to attempt to specify such standards at this time. Instead, we strongly urged the Court to conclude that the presence or absence of legal barriers to local-exchange competition should be a major focus in considering any BOC requests for waivers to provide in-region interexchange services as well as a focus of the next triennial review of the interexchange services prohibition.

Under orders entered by the Court, any further responses to our recommendations are due May 12, and the United States' final reply is due May 22. After receiving these filings, the Court will determine whether it will hold a hearing before making a decision on our recommendations and the motions filed by the BOCs for removal of the decree restrictions.

In closing, I would like to emphasize to the Subcommittee the limited scope of the issues now before the Court. Judge Greene's decision concerning the decree restrictions will have a broad impact on the telecommunications industry. Nonetheless, these proceedings concern only the possible removal of certain restrictions imposed by an antitrust consent decree under the standard provided by that decree. Thus, the United States' recommendations do not reflect any attempt to determine whether BOC entry into particular markets is desirable or undesirable as a matter of business judgment, regulatory objectives, or social policy. Nor do we do take any position before the Court regarding restrictions or controls that Congress, state legislatures or regulators might seek to impose to further specific policy objectives. Rather, we look only to the decree's antitrust-based standard; that is, whether BOC entry into currently prohibited lines of business would create such a substantial threat to competition in those markets as to warrant retention of the line-of-business restrictions as a supplement to existing regulatory controls and antitrust enforcement. The recommendations we have made were based on a thorough factual analysis of the current state of the telecommunications industry and a careful application of the decree's standard to those facts.

The telecommunications industry is far different today from what it was when the AT&T case filed in 1975. The benefits the decree has provided, as well as technological and regulatory developments that have occurred in the industry, have led us to conclude that most of the decree's restrictions are no longer necessary to protect competition. We believe that consumers will benefit from increased competition that will result by removing and modifying the decree restrictions as we have recommended.

Mr. Chairman, that concludes my prepared remarks. I would be happy to respond to any questions you or other members of the Subcommittee may have.

U.S. Department of Justice

Office of Legislative and Intergovernmental Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

26 MAY 1987

Honorable Howard M. Metzenbaum
United States Senate
Washington, D.C. 20510

Dear Senator Metzenbaum:

While testifying before the Monopolies Subcommittee of the Senate Judiciary Committee on April 30, 1987, concerning the Department of Justice's February 2, 1987 recommendations to modify the line-of-business restrictions in the AT&T decree, you asked that Acting Assistant Attorney General Charles F. Rule supply the Subcommittee with a list of former Administration officials who have "lobbied" the Department on the subject of changing the AT&T decree. In responding to this request, the Antitrust Division has searched its records of correspondence received by the Division and Mr. Rule's phone logs. As a result of that search and Mr. Rule's own recollection, we have developed the list below.

It is possible that there may have been other (most likely lower-level) former officials who have discussed the decree with Division personnel. Moreover, as indicated below, some of the individuals (for example, former Deputy Attorney General Edward C. Schmults) may never have actually discussed the AT&T decree or its modification with anyone in the Department but have nevertheless been listed because they discussed related issues with Division personnel.

As well as developing the list below, the Department also searched the Attorney General's correspondence. That search has revealed only two letters (both from William P. Clark, dated October 1, 1985 and March 31, 1986 respectively) that were sent by former Administration officials. I am attaching those letters.

The October 1, 1985 letter from Judge Clark related in part to Pacific Telesis Group's ("PacTel") waiver request, which was then pending, to acquire Communications Industry, Inc. Accordingly, that letter was filed by the Division with the court on December 9, 1985 and made part of the public record in connection with the Division's response to PacTel's waiver request. Judge Clark's March 31, 1986 letter, which related exclusively to the report and recommendations concerning the line-of-business restrictions being undertaken by the Division at that time, was referred to the Division and to its consultant on this matter, Dr. Peter Huber, for their consideration in connection with preparation of their reports.

The following individuals, who served in the Executive Branch at some point during President Reagan's Administration, have represented different parties with diverse interests in the AT&T decree before the Department. They are:

1) Bernard J. Wunder, Jr., the former Assistant Secretary of Commerce in charge of the National Telecommunications and Information Agency ("NTIA"). Mr. Wunder, who was a partner in the Washington offices of the McNair firm and is currently a partner in Wunder and Diefenderfer, represented BellSouth before the Division on various decree-related issues;

2) David J. Markey, also a former Assistant Secretary of Commerce in charge of NTIA. Mr. Markey, who is now a Vice President of BellSouth, has been at several meetings outside the Department at which Division officials were present and at which decree-related issues were discussed;

3) Bruce E. Fein, a former Associate Deputy Attorney General and former General Counsel of the Federal Communications Commission. Mr. Fein, who represented one of the Bell Operating Companies, had at least two meetings in 1985 with Division officials to discuss the decree generally;

4) Fred F. Fielding, the former White House Counsel. Mr. Fielding, now a partner at Wiley, Rein and Fielding, represents the American Newspaper Publishers Association and communicated with Department officials, advocating that the information services prohibitions (or at least the electronic publishing aspect of it) be retained;

5) James J. Tozzi, the former Deputy Administrator of the Office of Information and Regulatory Affairs at OMB. Mr. Tozzi, who is now a consultant, represents AT&T and has communicated with the Department, advocating that the decree not be changed;

6) Michael Horowitz, the former General Counsel of OMB. Mr. Horowitz, now a partner at Dickstein, Shapiro and Morin, apparently has been retained by several of the BOCs in connection with the Department's February 2, 1987 report to the court. Mr. Horowitz has communicated with Department officials with respect to that report;

7) Abbott B. Lipsky, the former Deputy Assistant Attorney General for Policy Planning and Legislation in the Antitrust Division. Mr. Lipsky, who had no involvement in AT&T matters while at the Division, is now a partner in the Washington office of King and Spaulding. Mr. Lipsky represents BellSouth and has communicated with the Division on numerous occasions concerning decree-related issues;

8) Stanley M. Gorinson, the former Chief of the Special Regulated Industries Section of the Antitrust Division. Mr. Gorinson is a partner in the Washington office of Pillsbury, Madison and Sutro. Although Mr. Gorinson represents PacTel and has appeared before the Division in that capacity, his representation has involved primarily non-decree issues;

9) Dennis E. LeBlanc, a former White House employee. Mr. LeBlanc, now an employee of PacTel, has been present at several meetings with Division employees; and

10) Edward C. Schmults, the former Deputy Attorney General. Mr. Schmults, who was recused from the AT&T matter while at the Department, is now general counsel of GTE. Mr. Schmults has had a few conversations with the Division, none of which appear to have been directly related to the AT&T decree.

In addition to those individuals listed above, both former Assistant Attorney General Doug Ginsburg and Mr. Rule have sought the personal views on various decree issues from several former Division employees, including William F. Baxter, former Assistant Attorney General, Richard O. Levine, former Director of the Office of Policy Planning, and Kevin Sullivan, former Assistant Chief of the Communications and Finance Section. Those individuals have not, however, "lobbied" the Division with respect to the decree on behalf of a client.

I hope this letter provides you with the necessary information.

Sincerely,

JRB

John R. Bolton
Assistant Attorney General

Attachments

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William P. Clark
of Counsel

October 1, 1985

The Honorable Edwin Meese, III
Attorney General
Department of Justice
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Washington, D.C. 20530

Dear Ed:

As a recently appointed director of Pacific Telesis Group, I am seriously concerned about the Antitrust Division's enforcement policy regarding the restrictions imposed on the Bell Operating companies (BOCs) across the country in the 1982 Consent Decree mandating AT&T's divestiture.

Assistant Attorney General Ginsberg's recent response to a pointed inquiry from Congressmen John Dingell confirms that the Antitrust Division's approach to the restrictions is theoretical, inflexible and burdensome. As shown below, there is a rising tide of criticism from knowledgeable sources that this enforcement policy is contrary to the public interest and will lead to outdated local exchange telephone service at increasingly higher prices to the average consumer.

Of immediate concern to Telesis is the Division's review of a waiver request for the acquisition by Telesis of Communications Industries, Inc. ("CI"), a company with significant cellular mobile radio and paging interests across the country. Extensive discussions indicate that the Antitrust staff may be considering even broadening its restrictive approach to activities that are largely outside Telesis' local exchange area and clearly could not raise competitive concerns.

The Department's current enforcement policy is in direct conflict with the views of the National Telecommunication and Information Agency ("NTIA") which, by Executive Order, is "the

President's principal advisor on telecommunications policy". NTIA, in its comprehensive report on U.S. telecommunications policy issued in July 1985, strongly criticizes the restrictions as being contrary to the public interest. With respect to the key prohibition against the operating companies providing "information services" the NTIA reports states emphatically:

> . . . prompt attention to eliminating the prohibition on "information services" is required. The clearest effect of this prohibition, in too many instances, is to deny the public choices which otherwise would be available. The prohibition is also unfair since it places the Bell Operating Companies at a distinct disadvantage in relationship to AT&T, IBM and its planned affiliate, MCI, and other companies that are increasingly entering the local exchange services market on a selective basis.

NTIA is equally critical of what its report carefully documents as the "needlessly burdensome, bureaucratic" process that has developed under the waiver procedure:

> The present process associated with securing waivers of the AT&T consent decree is unduly and needlessly burdensome, bureaucratic, and duplicative of regulatory functions assigned by statute to the FCC and state regulatory agencies. This process has turned the Antitrust Division and the court into a virtual day-to-day regulator of telecommunications.

Needless to say, the Department's advocacy of this cumbersome process is difficult to reconcile with our administration's strong commitment to deregulation.

The Department's enforcement policy also appears increasingly at variance with the regulatory efforts of the FCC which is taking steps to change its rules to avoid such adverse effects. As Congressman Dingell stated last Wednesday, the FCC's efforts will be frustrated by the Department's rigid enforcement policy:

> While the FCC is on the right track with regard to upgrading the local network, the same cannot be said about the Justice Department.

* * * *

> What good does it do for the FCC to authorize the Bell companies to provide new advanced communications services inside the public networks if the Justice Department insists on prohibiting them from providing these services at all?

In many instances, conditions imposed during the waiver process appear to go far beyond what was originally contemplated under the decree. Certainly that is so with respect to certain conditions suggested by the staff in connection with the Telesis acquisition of CI. Indeed, the cumbersome waiver process itself was neither contemplated nor intended. As pointed out in a recent article in the Yale Journal on Regulation:

> The decree provided that the BOCs may diversify into new geographic areas and product lines upon a showing that there will be no anticompetitive effect on the "target market" involved. However, the July 1984 decision of the judgment court established an elaborate waiver review process for approval of new BOC activities. * * * *
>
> The practical effect of the court's protectionist approach is to shield interstate telecommunications companies, including AT&T, from their most likely potential competitors, the BOCs. Although the judgment court, after many months of delay, ultimately approved several diversification proposals filed by the BOCs, the burdensome regulatory process has prevented the BOCs from responding rapidly to changing market conditions and new customer demands.[1/]

The authors go on to note that the competitive restrictions imposed on the BOCs are preventing realization of tangible public benefits from the divestiture and are likely to lead to increased public skepticism as to the wisdom of the decree:

> Constraining BOC activities can only lessen the likelihood that the AT&T divestiture will

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[1/] MacAvoy & Robinson, Losing By Judicial Policymaking: The First Year of the AT&T Divestiture, 2 Yale Journal on Regulation, 225, 253-4 (1985).

> yield tangible public dividends. One plausible, if not anticipated, rationale for divestiture was that it created seven new potential competitors for AT&T. If this potential is now suppressed, policymakers may find it increasingly difficult to explain to a skeptical public why divestiture was necessary. If competition is desirable, all actual and potential competitors should be afforded an opportunity to compete. The geographic and product line constraints on the BOCs, therefore, should be eliminated.[2]

Pacific is not actively seeking to re-enter the interexchange business at this time; however, because of the restriction on information service, it will not be able to provide all of the service options that AT&T will be able to provide. Thus Pacific may not in the future be able to compete fully with AT&T and others who are not so limited.

The Antitrust Division continues to advocate strict adherence to the restrictions based on theoretical concerns that, if the BOCs are allowed to provide additional products or services, they may discriminate against other providers and may cross-subsidize their new activities with revenues from their local services. Despite the Antitrust Division's claim that "experience shows" that the BOCs have an incentive to discriminate or cross-subsidize with regard to information services, such claims were not part of the AT&T antitrust case.

As to the Division's concern about possible discrimination,the BOCs, if allowed to provide information services, are not likely to risk the consequences of discrimination against anyone. Ed, as you know, the activities of the BOCs are under close scrutiny by Judge Greene, the Antitrust Division, the FCC, and a myriad of state regulatory bodies, as well as AT&T, GTE, IBM/MCI and other competitors. The BOCs have every incentive to make sure there is no basis for a claim of discrimination by anyone. As to the second concern, the NTIA report correctly points out that cross-subsidization is not a realistic concern:

> The notion [behind the Consent Decree] is that local telephone operations constitute a uniquely lucrative source of revenues to support anticompetitive cross-subsidization in unregulated markets. There is little support

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[2] Id., at 255.

> for this view in the literature on industry economics. Significant subsidies have flowed particularly from the interstate long-distance to local telephone operations. Indeed, local rates today fail to cover the revenue requirements of a substantial part of local exchange plant. If local companies are unable to support much of their local investment in nontraffic sensitive plant today through local service charges, it is difficult to see how they could fuel anticompetitive cross-subsidies in other markets.

The AT&T divestiture has placed additional upward pressure on telephone rates because AT&T and others can now bypass the local distribution facilities of the BOCs. NTIA, the FCC and the California Public Utilities Commission have recognized the threat posed to the BOCs and the local rate structure by such bypass operations. Mr. Ginsburg's letter to Chairman Dingell dismisses such concerns by acknowledging only a single example of bypass in New York and fails, therefore, to acknowledge the magnitude of the problem.

The restrictions prevent the BOCs from offering new services that more fully utilize their equipment and business expertise to provide an expanded array of services to consumers. Moreover, as pointed out by NTIA, the restrictions unfairly limit the ability of the BOC's to compete with AT&T, IBM/MCI and GTE at a time when the customer base which must support local service is being eroded by those competitors.

Ed, the Department's enforcement of the line of business restrictions is sufficiently controversial and important to warrant your personal attention. As Congressman Dingell suggested:

> The Department of Justice, under the new leadership of Attorney General Meese, has an opportunity to take sensible steps to solve these problems in a manner consistent with the Reagan Administration's own deregulatory objectives. The Department should take the lead in proposing modifications to the sweeping restrictions that currently handicap the Bell companies.

The opportunity exists to initiate a policy review in conjunction with Secretary Baldridge to take a fresh look at whether the Department's current policy is too restrictive. In the meantime, I hope you will ensure that Telesis' acquisition of CI is promptly reviewed under the same standards the Division applies to acquisitions in other industries. It would be a serious blow to Telesis if this important diversification move were to fail because it became needlessly bogged down in a protracted attempt by the Division to expand its regulatory powers.

Ed, I hope the above has been helpful to you. I am certain you will make the correct decisions in this vital area. Kindest personal regards.

Sincerely,

Bill

William P. Clark

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William P. Clark
of Counsel

March 31, 1986

The Honorable
Edwin Meese III
Attorney General
Washington, D. C. 20530

Dear Ed:

As we have discussed before, you will submit a report on behalf of the Department of Justice next January on any continuing need for the "line of business" restrictions of the AT&T consent decree. This court-ordered process provides the Administration with an opportunity to review the 1982 decree in light of major changes, and other circumstances, in the communications industry.

It has been pointed out that the review necessarily involves communication policy, trade and technology issues, as well as antitrust concerns. I am certain that Mac Baldrige would agree that all aspects of any report submitted to the court be considered in the interagency process. Industry and commerce in California, particularly Pacific Telesis, look toward the good day when the entire responsibility for the process will shift from the Judiciary to the Executive Branch. Should you desire further comment or contribution from the private sector to assist the ultimate determination, please let me know.

Sincerely,

Bill

William P. Clark

cc: The Honorable
Malcolm Baldrige

Senator METZENBAUM. Thank you, Mr. Rule.

Mr. Rule, I am confused by the Department's change of position on the need for these restrictions on the Bell Companies. Maybe you can straighten me out.

In 1982, the Department negotiated the decree which banned the Bell Companies from competing in long distance manufacturing and information services, for as long as they kept their local telephone monopolies. The Department was a party to a settlement. The settlement said, no, you couldn't compete in long distance, couldn't compete in manufacturing, and couldn't compete with respect to information services as long as the Bell companies keep their local telephone monopoly.

The Department strongly supported the decree after divestiture took effect in January of 1984. As late as the fall of 1985, the Department was squarely behind the decree. In a September 19th, 1985, letter to Chairman Dingell, for instance, then Assistant Attorney General Ginsburg strongly defended the Antitrust Division's enforcement of the restrictions. He wrote that the Bell Companies still had the "practical ability to disadvantage competition" through their monopoly control over access to the local network, and that as long as that was so, "it would be extremely unwise to consider a modification in the current ban on the BOCs providing interchange services and information services."

He warned that "Prematurely allowing the BOCs to enter these markets would risk frustrating the basic purpose of the decree."

Several days later, the Attorney General, Attorney General Meese received a letter from the former National Security Advisor and White House Chief of Staff, William Clark, written in Judge Clark's capacity as a Director of the Pacific Telesis Group. In that letter, Judge Clark complained that the Antitrust Division's enforcement of the restrictions had been too strict and urged that they be relaxed. He made a personal appeal to the Attorney General of the United States to intervene. He wrote, and I quote, "Ed, the Department's enforcement of the line-of-business restrictions is sufficiently controversial and important to warrant your personal attention."

This past February, of course, the Department reversed its earlier position and recommended that the restrictions be drastically cut back.

Now, Mr. Rule, did Attorney General Meese in any way, inferentially, discussions, notes, any way at all, participate in any way in the Department's decisionmaking process which led up to its current recommendation that the restrictions be relaxed?

Mr. RULE. As I discussed with your staff in accepting the invitation to come here today, which I was happy to take, this is a matter that is currently before Judge Greene. And I am happy to discuss the position that we took in our filings. However, as in any litigation matter, the discussions and internal deliberations that led to a particular position are perhaps best addressed by the Committee if it still believes it is necessary after this process is complete.

But let me address what I think I can, based on the filings.

This is the Huber Report. It consists of somewhere between 600 to a thousand pages of study. There are over 300 pages of analysis based on that study and based on the standard that was in the decree. That is the reason that the Department is making its recommendation. I believe, and I think I speak for the staff when I say that it believes, the recommendations we have made are justified based on the facts and based on the standard. That is the only argument and that is the only reason that anyone should consider. The judge is the one who has to consider whether to change the decree.

When the Department of Justice and AT&T presented the decree to Judge Greene, we presented it based on what is know as the quarantine theory: in effect you split the Bell Operating Companies off from AT&T, and you keep the BOCs out of competitive markets forever.

Senator METZENBAUM. Mr. Rule, you have given me a long discussion to a very simply question.

My question calls for only a yes or a no answer. My question is, did Attorney General Meese participate in any way in the Department's decisionmaking process which led up to its current recommendations that the restrictions be relaxed.

Now, I know the ethics of the bar. I know that you can have discussions in a law office, but we are talking about something far more important than that. We are talking about the fact that a director of a major company affected by the decision wrote to the Attorney General of the United States, asked him to personally intervene—it was a personal letter, it was not a professional letter, it was a personal letter.

Now, all I am asking you is, did the Attorney General participate and to what extent did he participate in this change of position?

Mr. RULE. Senator, let me just say this. I understand that that is a yes or no question. I am a little concerned because as I indicated to your staff in accepting this invitation since this is a matter that is currently pending before a court, I had asked that internal deliberations and that sort of thing which are perfectly——

Senator METZENBAUM. This is not a deliberation. It is not a deliberation. I am not asking what he said. I am asking, did he participate?

Mr. RULE. It involves a communication between the Attorney General and members of his staff. And my failing to answer should not be taken in any way as any inference one way or another as to what the Attorney General has done.

Senator METZENBAUM. So why don't you answer? If he didn't, it is a simple no. That has got nothing to do with the court case. There can only be one inference, only one inference, if you refuse to answer. Because if you answer no, then it couldn't have any impact upon your presentation to the court.

Mr. RULE. Senator, I appreciate that. But I am a little concerned that I accepted the invitation because of a concern about these sort of questions being asked, and I was assured by the staff that this would not be the nature of the questions that would be asked of me. And that concerns me.

Senator METZENBAUM. Mr. Rule, my staff tells me that they assured you we would not ask you about internal deliberations. We are not asking you what those—who said what. We understand that.

We are asking you did the Attorney General involve himself in this decision? Now, that is just a simple yes or no answer. And if you don't answer it, there is only one inference that can be arrived at, and that is that the answer is yes. Because if it is no, then certainly it is very simply, no, he didn't, period. But you are not willing to say that.

Mr. RULE. I can tell you, if you want to know whether the Attorney General ordered us to come out one way or another on this, the answer is no.

Senator METZENBAUM. That isn't my question. I am not asking you did he order you to.

I am asking you did he participate, was he involved, did he ask you to reevaluate? Did he do anything in this matter?

Mr. RULE. The reason that we reevaluated this is because Judge Greene asked us to reevaluate it. We committed to reevaluating it——

Senator METZENBAUM. I am not asking you what Judge Greene asked you. I am asking you what Mr. Meese did. Did he or didn't he? Did he or didn't he? Yes or no.

Mr. RULE. Did he or didn't he what?

Senator METZENBAUM. I will ask you the question again.

Did Attorney General——

Senator HATCH. Howard, you are giving me a headache. Now, come on. You don't have to yell like that.

Senator METZENBAUM. Well, you may leave.

Senator HATCH. I wouldn't leave until——

Senator METZENBAUM. I am going to ask——

Senator HATCH. You can tone it down a little bit. Jeepers.

Senator METZENBAUM. I will tone it down very softly.

Senator HATCH. Okay. That's better.

Senator METZENBAUM. Because I don't want you to——

Senator HATCH. I love Howard Metzenbaum's toned down voice. It is really a beautiful thing, I will tell you.

Senator METZENBAUM. It is. It is sonorous. [Laughter.]

Did Attorney General Meese——

[Laughter.]

Senator METZENBAUM. Did Attorney General Meese participate in any way in the Department's decisionmaking process which led up to its current recommendations that the restrictions be relaxed?

Mr. RULE. The Attorney General approved the recommendations that were made to the court on February 2nd, yes.

Senator METZENBAUM. Did he participate any further than that?

Mr. RULE. Well, he approved the recommendation that was made to him.

Senator METZENBAUM. Was it at his instance that the issue was reexamined?

Mr. RULE. No. It was at Judge Greene's insistence. That was a commitment we made in 1982. That is why we did it. We did it according to the standard that Judge Greene made. It is in there.

When we wrote the letter to John Dingell, we wrote it prior to even having hired Peter Huber. Peter Huber conducted a year's study, talking to everybody in the industry. We have had a lot of experience with this decree. We very carefully approached the question of applying the judge's standard in the decree. We concluded on the basis of the facts, applying the standard to those facts, that the recommendations we made to the court were appropriate and that the court should accept them. We did that in good faith based on the facts. And that was it. And that's what this is about. And that's what Judge Greene has to decide.

Senator METZENBAUM. Did Attorney General Meese sit in on the discussions or deliberations in connection with your arriving at the conclusion that you did? Just a yes or no answer very softly.

Mr. RULE. I still come back to the fact that this is a matter that we are presenting to Judge Greene. On any other matter that we were presenting to any other court, we would decline to respond to those sorts of questions.

I think there is a very good reason for us to decline to——

Senator METZENBAUM. But you don't understand, that here we have a case where the director of a corporation has written a personal letter to the Attorney General, and has asked him to intervene. This is not the ordinary matter that you have that you are considering the case in your office. This ties in with the fact that Mr. Clark had written to him and said to him that—he particularly asked him to intervene.

Now, let me repeat it to you. In that letter, Judge Clark complained that the Antitrust Division's enforcement of the restrictions had been too strict and urged that it be relaxed. He made a personal appeal to the Attorney General to intervene. He wrote, and I quote—he wasn't saying Mr. Attorney General—he was saying, "Ed, the Department's enforcement of the line-of-business restrictions is sufficiently controversial and important to warrant your personal attention."

So I am asking you did he give it his personal attention?

Mr. RULE. When he approved it, he turned his personal attention to it. But the recommendations, the way they were developed was in accord with, and based on, what Judge Greene asked us and required us to do.

I take full responsibility for the recommendations. I believe in them fully. Nobody told me what decision to come out with. I did it on the basis of the facts. And there was no pressure from any quarter. The decision and the conclusions were arrived at based on the analysis that is contained here. This is where you will find the sum total of the reasons for the recommendations.

Senator METZENBAUM. I repeat my other question.

Did Mr. Meese sit in on some of the discussions, deliberations, or with you or with other members of the Department in discussing this issue?

Let the record show that the witness did not see fit to respond. Unless you have a further response.

Mr. RULE. Well, the only response I can add is that, ultimately, the decision was discussed with the Attorney General. The recommendations were developed from the bottom up. Everything, I believe, was totally proper. The Attorney General, as in my experience he always does, acted totally properly. There was no intercession in any way as suggested by your question.

Frankly, I would hope, and I had hoped in coming up here, that folks would focus on the merits of our recommendations. I think there are things to be discussed there. But we stand by the public remarks and the public explanation of our recommendations.

Senator METZENBAUM. Let me ask you, to your knowledge, did any other former Administration officials lobby Mr. Meese or others in the Department on this issue, you or anyone else?

Mr. RULE. Did anyone ever lobby—did anyone ever talk to anybody about the decree?

Senator METZENBAUM. Yes.

Mr. RULE. Gee, I have talked to a lot of people over the last 3 years, as most people have in the Department. And people——

Senator METZENBAUM. Former Administration officials?

Mr. RULE. Former Administration officials. None that come to mind have lobbied me personally.

Senator METZENBAUM. Will you get back to us if you think of any that do not occur to you at the moment, former Administration officials being involved in discussing this case with you at the Department or the people in the Department?

Mr. RULE. We will certainly do that.

Senator METZENBAUM. Following Judge Clark's letter to Mr. Meese, on Telesis' behalf, the tone of the Antitrust Division's defense of the restrictions actually seemed to change. Whereas, in September 1985, Antitrust Chief Ginsburg was saying it was premature and unwise to modify the restrictions, a few months later in March 1986, he was talking about, "rapid changes" that could make the restrictions obsolete and assuring Congress that the Department "will not fall into the trap of enforcing fixed rules and regulations beyond their useful life."

Isn't it fair to say the Department's position began to change in this September 1985 to March 1986 period?

Mr. RULE. No. The point of the letter to Congressman Dingell was that, at that time, we didn't feel a study as to whether the restrictions were still necessary was warranted. The bills that were before the House at that time would have removed the restrictions and allowed the Bell Operating Companies into new industries.

The bill we supported would simply have transferred jurisdiction, in effect, from Judge Greene to the FCC. But there was always the expectation that we would provide the court or—the FCC, if jurisdiction had been transferred—with a report on competition in the telecommunications business, and that any change in the restrictions should be based on such a comprehensive study.

The comprehensive study has now been completed. We have looked at it very carefully. On the basis of that comprehensive study, we have made the recommendations, as we were asked to do by Judge Greene.

Senator METZENBAUM. When did you receive the comprehensive study?

Mr. RULE. We received it in November of 1986.

Senator METZENBAUM. Isn't it the fact that the Department's position began to change between December of 1985 and March of 1986, approximately six, seven months prior to your ever having received the report? Mr. Ginsburg's position was changing during that period.

Mr. Rule. Well, having been involved in this myself since the middle of 1984, I think everybody's position, has evolved constantly, and I imagine it will continue to evolve.

But there certainly was no radical shift or radical change at any time during that period. It is important to keep in mind that, in the Dole bill, all the Administration was supporting was a change of venue, if you will, to the FCC, because we felt that it could better implement the decree.

But in terms of changing the restrictions, we wanted to withhold judgment, and we did withhold judgment until we received Peter Huber's report, and until we had a chance to analyze that report and make recommendations to the court.

Senator Metzenbaum. I have some additional questions, but two of my colleagues are here and I am sure they may have some questions, and I yield to Senator Hatch and Senator Thurmond.

Senator Hatch. Thank you, Senator Metzenbaum. And personally I want to congratulate you for holding these hearings. I think they are very important hearings and we appreciate your looking into these matters.

Mr. Rule, in your statement, you note that the Justice Department's recommendations for modification of the consent decree result from your examination of changes in competitive conditions in the telecommunications industry since the 1982 divestiture.

What changes in the market and regulatory developments have you identified that justify lifting the restrictions imposed by the consent decree on Bell Operating Companies against consumer premises equipment?

Mr. Rule. Well, first of all, and I think this is extremely important, rather than having one large monolithic AT&T, you now have AT&T plus seven regional holding companies. At the time before the decree was entered, it was very difficult for the FCC to look at the various costs of AT&T and try to properly allocate them.

The FCC feels now that, with seven RBOCs to check against one another, and also to check them against AT&T and others, that it is better able to contain and to allocate costs. The FCC developed some cost allocation principles, and it has required the Bell Operating Companies to file manuals according to those principles.

The FCC has also adopted rules of equal access, rules that protect various things like sensitive customer information, rules that ensure nondiscriminatory interconnection with the local system, a whole range of rules that we think protect competition in the equipment business.

What is particularly important, if you look at equipment, is that you are talking about markets that are characterized by some very large companies, like NEC, Siemens, Northern Telecom, and AT&T. These companies are, in many cases, larger than the Bell Operating Companies. It is unimaginable that any individual Bell Operating Company could dominate any of those markets. To the extent they try to get together in joint ventures or in mergers, the antitrust laws are there and they are adequate to control any adverse effect that might result from any such agreements.

Senator Hatch. I see. There is a great deal of concern that, since divestiture, there has been little increase in competition in local interchange markets. What factors have contributed to this continued bottleneck in local exchanges given the increase in competition evident in other areas of the telecommunications industry?

Mr. **Rule**. Well, it appears to us that the primary reason we haven't seen more competition there, and the primary reason, for example, we can't recommend the lifting of the restriction on long-distance or interexchange service, are local or State restrictions on the ability of others to compete for local service. The inability of other companies—an AT&T or an IBM, or an MCI or a GTE—outside of their own territory to be able to come in and compete for large customers on an equal basis with the Bell Operating Companies is a situation that really impairs competition.

We think there are some areas, for example, intraLATA long-distance service, where competition clearly is technologically feasible, but where some States simply prevent that. We think that is just as unwise as restrictions in the decree that no longer are justified based on the purposes of the decree.

Senator **Hatch**. Are there any other considerations beyond antitrust, such as trade, employment, consumer availability, that might affect the decisions concerning the provision of telecommunication services? For instance, what other considerations would be given in those circumstances?

Mr. **Rule**. Well, with respect to individual business decisions, that would have to be left up to the businesses. They will have to decide the extent to which, when they are allowed to get into local service, they will get into it.

One thing perhaps has been misrepresented by some. We have not said that, once you remove those restrictions, every part of local service will be automatically capable of sustaining competition. For example, it is very unlikely that you or I will have more than one choice as to who will carry our calls out of our homes. It is too expensive to lay duplicate wire by our houses. But there are many other areas where, if those restrictions were removed, the primary impediments will be technological. I have a great deal of faith in the ability of companies in this country to develop new technology and to be able to move into new areas and provide new services at the local level for consumers, services that we can't even imagine today.

Senator **Hatch**. Well, that kind of goes into my next question that, really, some fear that if the Justice Department proposal were adopted, revenues derived from monopoly ratepayers at the local exchange level could be used to subsidize other activities of the Bell Operating Companies, such as the provision of information services.

Some believe that such subsidization will result in a high cost for consumers. But it seems to me that increased competition in areas, such as the provision of information services or manufacturing of equipment, is likely to result in lower costs to consumers over the long run.

It that your view?

Mr. **Rule**. I think that is right. One of the things that we found in our study, particularly in the area of information services, is that there may be some information services that are not available today, or certainly not available at an affordable price today, because the Bell Operating Companies can't provide them. The Bell

Operating Companies, if they were allowed to provide them, could provide them at a lower cost. We think that would be a benefit to the local telephone user. Some of those services which may not be that clearly recognized by consumers, but may be able to, for example, allow other companies to operate more efficiently by better utilizing telecommunications and information technology, which in turn may allow them to compete even more effectively both here and abroad. That would make this country more efficient and more competitive overall.

Senator HATCH. I have taken enough time. But just let me ask one other before Senator Thurmond.

And that is what is your present position with regard to long distance telephones?

Mr. RULE. The present position with respect to long distance really is the same in terms of the concepts and the principle for allowing the Bell Operating Companies into long distance as it was when we made our initial recommendation on February 2nd.

Senator HATCH. Do you think it is the same?

Mr. RULE. Sir?

Senator HATCH. Do you feel it is the same?

Mr. RULE. I feel it is the same. The question we had to face last Monday was how best to implement what we thought was the appropriate areas they should be allowed to go in to. We decided that rather than go through the very difficult and imperfect process of trying to draw new lines in the decree that may create very difficult problems, both for our enforcement and for the competitors out there, it was much better to approach this issue on a case-by-case basis through the existing waiver process. We think that we can implement those recommendations just as effectively, indeed more effectively using the current waiver process.

Senator HATCH. Okay. Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Hatch.

Senator Thurmond.

Senator THURMOND. Thank you very much, Mr. Chairman.

Senator Hatch has covered some of the questions I was going to ask. We are glad to have you with us.

Mr. RULE. Thank you, sir.

Senator THURMOND. When do you expect the judge to rule on your recommendations in this matter?

Mr. RULE. There are two more rounds of filings that are due through, I think, May 22nd, when the last filing is due. Judge Greene undoubtedly will have a hearing of some sort after that, and then take it under consideration.

Someone told me the other day that, in a speech, Judge Greene had indicated he thought a decision would be forthcoming in the fall. So perhaps we are looking at September, October when he will issue his decision.

Senator THURMOND. What is the briefing schedule?

Mr. RULE. We filed ours initially on February 2nd. Shortly after that, I think three weeks after that, various folks had to comment. We got 114 comments. Last Monday we filed our response to those comments and our proposed order. I think May 12th is when people then respond to our responses and to our proposed order. And I believe May 22nd is the date that we then have to respond to the responses. At that point Judge Greene will, I assume, issue an order for any further proceedings that he thinks are necessary for him to reach his decision.

Senator THURMOND. Mr. Rule, if the judge accepts your recommendations, and lifts the restrictions on the regional telephone companies, will the Justice Department still enforce the antitrust laws and look for law violations in those markets?

Mr. RULE. Yes, sir, we certainly will.

Senator THURMOND. Would the Department bring new cases?

Mr. RULE. Yes, if it turns out that the Bell Operating Companies have not learned their lesson, and I think they have, and if they try despite very substantial odds to engage in the sort of conduct AT&T engaged in. Those odds are very substantial and I think they will have enough sense, because of the cost in engaging in those activities, not to engage in them.

But if they do, they can count on us bringing a suit just as we will bring a suit in any industry where folks cross the line and violate the antitrust laws.

Senator THURMOND. Mr. Chairman, I am in a markup in Armed Services, and you will have to excuse me. I hope that Senator Hatch can come back and be here.

Senator METZENBAUM. Very happy to have you with us.

Senator THURMOND. I will try to get back, if I can, a little bit later. Thank you very much, Mr. Rule.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Thurmond.

Mr. Rule, while Senator Thurmond is still here, do you think if you had to engage in another case it would take longer than a decade for a new case against one of the BOCs?

Mr. RULE. I don't. One thing I want to say, though, since you brought it up, is that Judge Greene is to be commended. People sometimes forget what a marvelous job Judge Greene did, purely from the standpoint of moving this litigation along once he got a hold of it. He did an excellent job of moving the case along and showing that a case of this complexity could be moved through so quickly. Many people forget that. But that is one thing that Judge Greene, will be remembered for by lawyers anyway, for quite awhile to come.

Senator METZENBAUM. A new case might not go to Judge Greene.

Mr. RULE. It might not. But I have a great deal of confidence that many of the arguments raised by AT&T at the time, for example, that they didn't have to compete and that there existed a beneficial monopoly they had a right to protect, would fall by the wayside in a new suit, now, it's not just the courts and the Antitrust Division, but the FCC and State regulators, who recognize that competition is the appropriate public policy in telecommunications markets. I don't think those sorts of arguments that tended to slow down this case can be raised again.

But the fact is that any antitrust case does take a while.

Senator METZENBAUM. Let me ask you one other question.

One of the things that confuses me is the Department's flip-flop on whether regulation would be an adequate substitute for the decree.

In your 1982 competitive impact statement on the decree, the Department rejected a regulatory alternative to a decree, stating that it did not approach even remotely the effectiveness of the proposed consent decree in achieving conditions that would assure full competition in the telecommunications industry.

The Department persuaded Judge Greene to conclude that the problems of regulation were no more likely to be overcome in the future than they were in the past. But then the Department supported legislation just last year that would have substituted FCC regulation for the decree. And now it is urging Judge Greene to conclude that regulation is an adequate remedy.

What has happened in the past four years to convince the Department that this admittedly unacceptable regulatory alternative is not the preferred solution for protecting consumers and competition against unfair conduct by the Bell Companies? I don't understand why you have switched.

Mr. RULE. Well, there are several reasons. And the reasons have to do primarily with competition that has developed in the markets from which the Bell Operating Companies are currently excluded. It also has to do with the fact that, rather than having one monolithic AT&T that not only was a monopolist in all those other markets, but also was really the only telephone company for the most part in this country, we now have AT&T split up into eight parts. No one of these parts is anywhere close to being the size of the whole. No one of the parts is able to dominate like the whole did.

Like I said, in the equipment markets, for example, you have competitors who are much larger than the Bell Operating Companies They have regulated ratepayers, generally outside this country, from which they can draw cross-subsidies and generally draw them much more freely than can the BOC's. With them, the notions of the elimination of cross-subsidy and that sort of thing are perhaps not as ingrained there as they are here.

So it is very unlikely that the Bell Operating Companies could move into those markets and harm competition there. The real remaining question—and this is an issue that regulators have to address, as will perhaps Congress and the State legislatures—is whether there nevertheless may be some cross-subsidization or discrimination that won't really harm competition in these other, non-regulated markets, but may, to some extent, harm ratepayers.

There are two things we can say about that. One, the FCC today, unlike its position in 1982 when the decree was entered, says that it believes it is now capable of checking this cross-subsidy. I think the FCC and State regulators are much better able to identify those cross-subsidies where they exist.

There are other tools at the disposal of the various regulators. For example, a State concerned about adverse equipment procurement practices by its local telephone company that it felt was raising rates to local ratepayers could have a rule that made it very difficult for a Bell Operating Company to purchase from its manufacturing subsidiary. In other words, the State could try to force that local telephone company to buy from other sources.

There are many ways that the State regulators can protect themselves. They have many more options today than they did in 1982.

Senator **Metzenbaum**. They couldn't when they were just trying to regulate one company. Now you are suggesting that they are going to be more capable of regulating seven companies. And I just say to you that I think that regardless of any differences we might have on the question of thrust, I think, practically speaking, it is very difficult to understand how you think that somebody who couldn't regulate in the past is suddenly going to be able to regulate because there certainly is no evidence to be found anywhere in that report, or in any other report. There is no evidence that I know of that suggests that State regulatory bodies or the FCC or anybody that might be in a position to provide some regulation, that any of them are going to be able to do a better job than was done in the past when there was just one company.

Mr. **Rule**. I am not, and we are not, necessarily saying that, all of a sudden, we found a new group of people who were more competent than the old ones and that the old ones just were incompetent. Rather, what we are trying to suggest is that changes that have taken place since 1982 in the industry have made it much easier for any human to do the job that the regulators by Congress are empowered to do, that is, protect the ratepayers. Certainly the regulators, the FCC, at any rate, and many of the State regulators, believe that they can do that job. And some of them even believe that they could probably do a better job if they didn't have to worry about the Court's involvement and our involvement.

Senator **Metzenbaum**. I will be interested to hear from the Consumer Counsel from Ohio as to what his opinion on that subject is.

Thank you very much, Mr. Rule.

Mr. **Rule**. Thank you, Mr. Chairman.

Senator **Metzenbaum**. Our next witness is Sharon Nelson, Chairperson of the Washington State Utilities and Transportation Commission, here representing her commission and the National Association of Regulatory Utility Commissioners of Olympia, Washington. She also may have some comments with respect to that previous question.

Happy to have you with us. You know of our five-minute rule.

STATEMENT OF SHARON L. NELSON, CHAIRMAN, WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, ON BEHALF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

Ms. **Nelson**. Yes. Thank you very much, Mr. Chairman. Thank you for your invitation to testify before you today.

I am wearing two hats. I am here on behalf of NARUC, as you indicated. My written comments have indicated NARUC's position on these issues which is, essentially, lift the restrictions but with certain conditions.

We have a great consensus about the problems we face as State regulators, but we have a differing sense of the prescriptions for solutions of these problems. So, in my oral remarks today, I would like to confine my remarks to the Washington State position about these issues. And essentially those are two points.

We don't believe the facts have changed enough to justify the lifting of the restrictions at this time. We also do not believe that the current tools available to regulators have the ability to prevent the cross subsidies, the anti-competitive abuses that prompted the imposition of the restrictions in the first instance.

With respect to the reliance on the regulation question, we are as startled as you are, Mr. Chairman, about the Department's new found reliance on regulators. I think it is important to know with respect to the FCC that the Department is relying on the computer inquiry three rules, the open network architecture concept, and the recently promulgated joint cost rules, all of which are in their earliest phases of development. Whether they will be effective in preventing anti-competitive abuses in the future is at this point, I think, an open question.

We believe that the Department has for some reason suffered a short-term memory lapse and is ignoring the central unity of antitrust policy and regulatory policy concerns. And that is, the prevention of using the body of ratepayers of the monopoly as a bank, if you will, to finance the unregulated ventures of the parent.

The antitrust concern is that using those ratepayers as a bank undermines the competitive market because other competitors don't have access to that body of ratepayers on the same terms and conditions as the monopolist does.

We have appended to our written testimony today an organization chart of U.S. West, and I have done that just simply to illustrate to you the nature of the problem we face. U.S. West has been diversifying under the current regime quite nicely. Washington State has what we think is a strong affiliated interest statute, and yet we have difficulty tracing costs from the monopoly to the other affiliates of U.S. West.

It is also important to remember, with respect to State regulation, that many of these companies are seeking to diversify and to deregulate at the same time. That is, they are seeking from the State Legislatures, particularly in the West, either full-scale deregulation which would mean that we wouldn't have an affiliated interest statute to apply in the first place or a form of regulation, which is known as social contract type of legislation. The Nebraska legislation is the chief case in point.

With respect to the factual conditions, the Washington Commission has issued for two years in a row now our analysis of competitive conditions obtaining in our State. To be sure, we do see robust competition in the customer premises equipments markets. However, we see much less competition in the transmission services markets. And, it clear from Mr. Rule's comments just now that the Department is ignoring the whole question of monopsony power of the regulated operating companies in the CPE markets.

We are also concerned that the Department, with respect to its flop-flip, as you described it, recommendation on the interLATA transmission services, that it has set up as a sine qua non for the regional holding companies to obtain that relief; that they seek to affect the interpretation of the question of local franchise.

It is our opinion that changing the de jure monopoly will have little effect on the natural monopoly. In Washington State, we have never had regulatory barriers to entry into any of the markets we regulate. We have shared tenant services operating in Washington State. We have intraLATA toll competition. We have allowed the resale of Centrex type services, and yet the Bell Operating Company in our jurisdiction retains a 94 percent market share in the intraLATA toll business, and we do not see entry into the rural areas in our State. And we would just have to say that with respect to the innovations that the Department hopes would follow with free and open entry, that it again has forgotten that monopolies have their own reasons to impede competition, their own reasons to discriminate. And so we think would a cartel.

And with that, I will conclude and be pleased to answer any questions.

[Prepared statement follows:]

SUMMARY OF TESTIMONY OF SHARON L. NELSON, CHAIRMAN WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Mr. Chairman, members of the committee, thank you for your invitation to testify today. My name is Sharon Nelson. I am Chairman of the Washington Utilities and Transportation Commission (WUTC). I also serve as Vice-Chairman of the National Association of Regulatory Utility Commissioners (NARUC) Committee on Communications.

Today I will attempt to present the views of NARUC in addition to the views of the Washington Commission. As requested, my remarks will focus on proposed modifications to the AT&T consent decree.

State regulators' primary focus is on the effect diversification into high-risk lines of business will have upon the rates paid by telephone ratepayers. It has been the experience in many states that the Regional Holding Companies and their affiliates have aggressively sought through legislation, litigation, transfer of assets and corporate reorganization to avoid appropriate State regulation of their ventures into more competitive markets.

State regulators fear that revenues derived from monopoly ratepayers may be used to subsidize unfairly the "competitive" activities of the Regional Holding Companies. We believe it is incumbent upon us to prevent such cross-subsidies, to prevent, if you will, the milking of the monopoly "cash cow."

The importance of protecting monopoly customers from abuses of monopoly power, which prompted the line of business restrictions in the first place, remains undiminished. The fundamental conditions upon which the court based the original restrictions of the MFJ still exist. The case for elimination of these antitrust protections is simply not persuasive. In my view, the proponents of change have not met their burden of proof. Thus, it is my opinion that the restrictions on the Bell Operating Companies should not be eliminated at this time.

Thank you for your attention. I would be pleased to answer any questions.

Testimony of Chairman Sharon L. Nelson
Washington Utilities and Transportation Commission
Before the Subcommittee on Antitrust,
Monopolies and Business Rights
Committee on the Judiciary
United States Senate
April 30, 1987

Mr. Chairman, members of the committee, thank you for your invitation to testify today. My name is Sharon Nelson. I am Chairman of the Washington Utilities and Transportation Commission (WUTC). Before that, I was staff counsel to a Washington State legislative committee investigating regulatory reform in the telecommunications industry. I also serve as Vice-Chairman of the National Association of Regulatory Utility Commissioners (NARUC) Committee on Communications.

The NARUC is a quasi-governmental, non-profit organization founded in 1889. Within our membership are the governmental agencies of the 50 states, the District of Columbia, Puerto Rico and the Virgin Islands which are engaged in the regulation of utilities and motor carriers. The mission of the NARUC is to serve the consumer interest by seeking to improve the quality and effectiveness of government regulation in America.

Today I will attempt to present the views of NARUC in addition to the views of my colleagues on the Washington Commission. As requested, my remarks will address the Department of Justice's recently recommended modifications of the AT&T consent decree line of business restrictions. As the Committee is aware, this issue area is highly contentious. The views expressed in this testimony are filtered through my perspective and, thus, I am responsible for any errors or omissions.

THE NARUC RESOLUTION

The National Association of Regulatory Utility Commissioners has been an active participant before the divestiture court since the filing of the original proposed AT&T consent decree[1] in January 1982. Our participation has been guided by one fundamental principle: that the relief ordered by the court should be consistent with the long established national policy of providing universal telephone service to all Americans at affordable rates.

As you know, the decree divested the Bell Operating Companies from their parent, AT&T, on January 1, 1984. The Department's evidence at trial documented a wide range of abuses, including: misuse of the regulatory process,[2] abuse of proprietary network information,[3] manipulation of technical standards and network compatibility standards,[4] and bad faith negotiations regarding interconnection of potential competitors.[5] As the court found, for over 30 years the Bell Companies "shift[ed] from one anticompetitive activity to another, as various alternatives were foreclosed...."[6] In each instance, the misconduct was facilitated by Bell bottleneck control of the local exchange monopoly.

To prevent a recurrence of this anticompetitive conduct, the MFJ prohibited the Bell Operating Companies from offering interLATA long distance and information services, and from manufacturing telecommunications equipment. The decree also required the Bell Operating Companies to obtain permission from the court to engage in activities unrelated to their core telecommunications business. According to the DOJ and the court, these restrictions were the "necessary complement" to divestiture.

As a part of the judgment, the DOJ agreed to report to the court in January 1987 on whether changed competitive conditions reduce or eliminate the need for the line of business restrictions. In its report, DOJ recommended that the Regional Holding Companies be allowed to offer long distance service in certain areas, to provide information services, to manufacture telephone equipment, and to enter other telecommunications businesses. DOJ also recommended lifting restrictions prohibiting Bell Operating Company diversification into non-telecommunications businesses.[7]

The factual basis for the DOJ report was developed by the Department's consultant, Dr. Peter Huber, in a report entitled, The Geodesic Network: 1987 Report on Competition in the Telephone Industry. In relying upon the Huber report, DOJ offers a futuristic vision of a "geodesic" network in which switching, intelligence, and transmission connections are moved from the core of the network out to its edges. In Huber's view, the network is evolving from a few large, central office switches to numerous switching systems under the control of individual network users rather than monolithic common carriers. According to Huber, radical changes in technology, in the marketplace, and in regulatory conditions have reduced the risk that entry by the Bell Operating Companies will harm competition in many markets.

Pursuant to an order issued by Judge Greene, the NARUC, along with numerous intervenors in the case, including our Washington Commission and several other state regulatory commissions, filed comments on the DOJ report and recommendations on March 13, 1987. NARUC argued that the court should remove the restrictions if certain conditions intended to protect the public interest and the jurisdiction of state commissions were met. The recommended conditions prescribe that the restricted services be integrated into the switched network of the Bell Operating Companies, in accordance with the following concepts:

1) Each telecommunications service or function will be viewed and evaluated in terms of how it contributes to the enhancement of a "full service" network;

2) The accounting or corporate form for the offering of any new service is a state regulatory decision;

3) The state commissions will have the authority to enforce conditions deemed essential to assure that the basic network will be protected from erosion of its investment base;

4) The states will have full access to all books, records, facilities and premises of the Bell Operating Companies and all affiliates.[8]

As the NARUC comments make clear, state regulators' primary concern is the effect diversification into high-risk lines of business will have upon telephone rates. Many states have seen Regional Holding Companies and their affiliates aggressively seeking through legislation, litigation, transfer of assets and corporate reorganization to avoid appropriate State regulation of their ventures into more competitive markets.

State regulators fear that revenues derived from monopoly ratepayers may be used to subsidize unfairly the "competitive" activities of the Regional Holding Companies. We believe it is incumbent upon us to prevent such cross-subsidies and the milking of the monopoly "cash cow."

A recent NARUC staff subcommittee report on audits of five Regional Holding Companies illustrate some of the problems caused by diversification.[9] The Report focused on four problem areas that were common to all the Regional Holding Companies investigated.

First, the Subcommittee found that during the audit process the companies consistently attempted to block access to accounting and cost allocation records. Often, the information that was provided was of low quality. The companies frequently attempted to delay the audits by challenging the regulators' need for information. In some instances, court action was required to obtain needed data.[10]

Second, the Regional Holding Companies, including U.S. West with which the Washington Commission is concerned, were found to have embarked on ambitious and unprofitable investment programs in highly competitive, unregulated ventures. According to Securities and Exchange Commission reports, in 1985 US West had the unhappy distinction of ringing up the largest losses from its competitive subsidiaries -- over $180 million dollars worth that year. The company is predicting that its unregulated operations will ,turn a profit in 1987, but according to its most recent quarterly financial reports, it is still incurring losses in that sector.[11]

Third, the Subcommittee found that a common practice among the Regional Holding Companies was to transfer valuable revenue producing services from the telephone companies to new unregulated subsidiaries. This practice has often resulted in a reduced "contribution" from the transferred service to the operating companies' general revenues. In some cases, the Subcommittee also reported that transferred services have been sold back to the telephone company at inflated prices.[12]

To illustrate the problem of loss of contribution: the operating company regulated by our Commission, Pacific Northwest Bell, transferred its highly profitable Yellow Pages operations to a US West publishing subsidiary, US West Direct, shortly after divestiture in January 1984. Since that time, the division of Yellow Pages profits has been guided by an affiliate agreement between Pacific Northwest Bell and US West Direct. Last year approximately $70 million was contributed by the directory publishing affiliate to the operating company, helping to hold down basic local exchange rates.

Despite this contribution US West Direct still managed to post a return on equity exceeding 30 percent in 1986. The operating company, however, has recently approached our Commission with a new affiliated publishing agreement that would reduce contribution in 1987 by a third, while actual revenues from publishing are expected to remain constant, and probably grow.

The reason cited by the operating company is the intensely competitive nature of the publishing industry. Our staff's view is that the contribution to the monopoly revenue requirement continues to be justified because the monopoly affords US West Direct a dominant market position.

Finally, the NARUC staff auditors were concerned about the telephone companies' gradual shift to a capital structure characterized by large debt issues and the transfer of virtually all net income to the parent Regional Holding Companies, with minimum equity infusions from them to the Bell Operating Companies. Such a structure may ultimately increase the cost of capital, leading to higher telephone rates.[13]

According to the NARUC report, the commitment of the Regional Holding Companies to providing quality residential telephone service has taken a back seat to "their drive to become successful conglomerates."[14] As a result, the report concludes, "telephone subsidiaries currently function as cash cows and talent pools for the competitive new ventures."[15]

The NARUC Subcommittee recommended that national legislation be passed to grant regulators needed access to the accounting records of the Regional Holding Companies' unregulated subsidiaries. They also urged consideration of a proposal by the Chairman of the Massachusetts Department of Public Utilities, to institute another round of divestiture that would separate the Bell Operating Companies from the Regional Holding Companies.

Absent national legislation, state commissions are beginning to develop their own strategies for tackling the problems brought to light in the Subcommittee's audits. At its recent Winter meeting, the NARUC Communications and Executive Committees adopted a resolution supporting the establishment of Regional Oversight Committees, based on the operating territories of the Regional Holding Companies. The purpose of the Regional Oversight Committees is to ensure the effective monitoring of the Regional Holding Companies' activities, to coordinate the sharing of information, to create a data base, and to support the development of state regulatory policies with respect to diversification and affiliate transactions.[16] The 14 state commissions having jurisdiction over the US West activated a US West oversight committee at a meeting in Denver last month.

VIEWS OF THE WASHINGTON COMMISSION

The Washington Commission also filed comments on the DOJ report with Judge Greene. Based on our review of the Huber report, the DOJ report and recommendations, and our own knowledge of the telecommunications industry[17], we concluded that DOJ's analysis is overly optimistic and does not accurately depict the current state of the telecommunications industry. In our view, the factual conditions that prompted the establishment of the line of business restrictions still exist. Instead of one AT&T, there now exist seven regional companies. The Bell Operating Companies still retain monopoly bottleneck power in their regions and are the only carriers with the ability to connect end users to any significant extent. There is no indication these facts will change in the near term.

DOJ's new-found faith in the effectiveness of regulation to check the Bell Operating Companies' potential for anticompetitive behavior is startling. Focusing principally on the FCC, the Department argues that changes in the regulatory environment suggest that regulation, despite its previous inadequacies, would now be able to police effectively the conduct of the Bell Operating Companies and to prevent them from abusing their monopoly control of local exchange bottleneck facilities. DOJ relies most heavily in this respect on the FCC's Third Computer Inquiry[18] and Joint Cost proceeding.[19]

In Computer III, the FCC abandoned its Computer II[20] rules requiring the Bell Operating Companies to offer enhanced services through separate subsidiaries. Instead, the operating companies will be permitted to offer these services directly, provided that they obtain FCC approval of plans to provide comparably efficient interconnection to competitors. The FCC also requires the companies to obtain approval of an accounting plan based on the Commission's Joint Cost rules and disclose to competitors network planning information.[21] According to Computer III, further relief will be provided in the future after implementation of a concept now known as "Open Network Architecture." This concept is anticipated to result in the modification of the operating companies' facilities in a way that promotes competition.

While DOJ emphasized to the court the potential benefits of the Computer III rules, it recognized that these rules are in their earliest phases of development. The Comparably Efficient Interconnection concept has yet to be put into practice.[22] Each of the Regional Holding Companies' comparable interconnection plans is subject to FCC approval after a period of public comment. Complex plans involving particularly lucrative services will no doubt be subject to considerable opposition and delay. In some cases, Comparably Efficient Interconnection will no doubt present a greater technical challenge than did the "Equal Access" requirement for alternative long distance carriers.

Open Network Architecture plans present similar problems but on an even larger scale. Open architecture plans need not be filed until February 1988, after which the FCC will open them to public comment. The actual form the "open network" will take, much less the effectiveness of this concept in creating a level playing field, is thus wholly unknown.

In its Joint Cost Decision, issued less than three month's ago, the FCC adopted standards to apportion costs between carriers' regulated and unregulated activities.[23] DOJ's reliance upon these new rules is no more well-founded than the Department's belief in the effectiveness of the nascent comparable interconnection/open architecture regime.

At this time, no Joint Cost manuals have been filed by the operating companies. Thus, the actual substance of the carriers' cost allocation plans is unknown. A more striking aspect of DOJ's reliance upon the FCC's cost accounting rules, however, is that the decision announcing those rules had not even been released at the time the DOJ report was filed. Thus, the Department was touting the effectiveness of unknown rules.

The Joint Cost order has neither passed through the final stages of FCC review nor been subject to appeal.[24] In fact, NARUC has a Petition for Reconsideration of the Joint Cost Decision arguing that the decision complicates jurisdictional cost separations. NARUC believes that if this matter is not corrected, the accounting rules should be referred to a Federal-State Joint Board for resolution. In sum, neither the Computer III rules nor the Joint Cost rules are adequate, in their present iterations, to warrant the court's reliance on them to safeguard against anticompetitive practices by the Bell Operating Companies.

It should also be noted that many Bell Operating Companies are actively seeking full deregulation or new legislation similar to that enacted in Nebraska in 1986. Thus, where regulation may previously have been only inadequate, future reliance on regulation to protect ratepayers or competition may be illusory.

With regard to the specific line of business restrictions, the WUTC objects to allowing out-of-region long distance service on the grounds that such service would be impractical and would promote rate deaveraging. We also advocate that the Bell Operating Companies be allowed to provide information services only after the Comparably Efficient Interconnection or Open Network Architecture plans have been approved.[25] In addition, if the court accepts DOJ's recommendation to remove the equipment manufacturing restriction, we believe manufacturing activities should be confined in structurally separated subsidiaries and affiliated manufacturers should be prohibited from supplying equipment to their Bell Operating Company.

Implicit in the DOJ report and the Huber study is the belief that the statutory monopoly should and will end. In fact, the Department asked the Court to encourage this result by making the destruction of the statutory monopoly the essential element of removing the restriction on Bell Operating Companies providing interLATA interexchange service in their own service areas as well as elsewhere. The DOJ and Dr. Huber want the Court to move the industry into a monopoly-free and regulation-free future with no consideration of the social goals of public service regulation. In our view, the states should be free to make their own judgments on whether there is a continuing need for entry restrictions. For example, in the state of Washington, we have proceeded in a deliberate fashion to allow entry into the intraLATA toll market, privately owned pay telephones, shared-tenant telecommunications systems in large buildings, and the resale of "Centrex" enhanced business services.

Dr. Huber noted that his personal vision of the future is that competition requires that open entry be "relaxed symmetrically at the state and federal levels."[26] However, given the nature of our federal system and given the varying philosophies among the states, the sort of symmetrical relaxation contemplated by Dr. Huber is likely to occur only through the pre-emptive authority of the Federal Government. Although the FCC does not now have total preemptive authority, it is evident that the DOJ is moving in a preemptive direction and seeks the Court's assistance in doing so.[27]

We believe the DOJ is simply missing the point. In analyzing the line of business restrictions, the unity of regulatory and antitrust concerns should be obvious. The opportunity and incentive for cross subsidization from the monopoly-based Bell Operating Companies to the unregulated ventures are real. If the Bell Operating Companies are permitted to shift cost responsibility from their non-regulated to their regulated operations, the result will be higher local rates and the ability to engage in unfair competition. And, if the non-regulated businesses do incur losses, ratepayers will find themselves confronted by higher costs of capital or additional improper cross subsidies.

As a state regulator, I am very concerned about diversification efforts by all of the utilities that we supervise. The perils of diversification are not news in the world of business. In the January 14, 1985 issue of Forbes, the magazine compared the performance of 41 highly diversified companies with an all-industry measure. In theory, Forbes said diversified companies ought to beat the all-industry medians. In other words, the median profitability of the 41 firms surveyed ought to exceed the all industry median. In practice, Forbes said that is not the case. The figure for the all-industry return on equity was 13.4 percent versus 11.8 percent and 10.4 percent for the two groups of diversifiers that Forbes surveyed.

Managers, too, are noting practical problems with diversification. The October 1986 issue of Working Smart examined the high tech company, Perkin Elmer. CEO Horace McDonell noted that his managers lost sharpness of focus and began ignoring losses. He stated:

> We poured money into these minibureaucracies until our administrative costs were equal to -- if not exceeding -- what we were spending on R & D. Finally, I had to ask myself what kind of high-technology company does that?

The stories of the Penn Central, the chemical companies, the food companies and others all have the same ring. Naive faith that Regional Holding Company management will diversify in a manner to maximize benefits to shareholders and ratepayers may be misplaced. Considerable risk is obvious.

In the case of US West, we have no effective way of determining how much capital is being diverted from the operating companies to the deregulated subsidiaries. Washington State has one of the toughest affiliated interest laws in the nation, but our accountants believe they cannot accurately trace the flow of money and resources from monopoly ratepayers to US West's unregulated subsidiaries. For your information, I have appended the most recent organization chart of US West. The sheer number of subsidiaries should provide some indication of the nature of our problem.

The Washington Commission urged the court -- and we urge this committee -- to reject a precipitous restructuring of the telecommunications industry before the full impact of the MFJ and current FCC policies is determinable. While the current market structure is probably not ideal, it is at least now becoming familiar. Customers are adapting. The Bell Operating Companies are thriving. Other industry participants are developing their own competitive strategies in the current regime.

In the interim, if the stockholders who own the Regional Holding Companies wish to invest their capital in new ventures, let them do so in corporations wholly separate from the public service companies which state commissions regulate and which have been supported by the ratepaying public for generations. In my view, the potential economic benefits of greater diversification by the Bell Operating Companies do not now outweigh the anticompetitive and anti-public interest risks which the DOJ and Dr. Huber failed to study adequately.

OTHER CONSIDERATIONS

Apart from the potential threats to competition and ratepayer interests, and the additional burden which adoption of DOJ's recommendations would impose on already limited regulatory resources, the suggested removal of the manufacturing restriction may also have an adverse impact on trade policy. Although I am certainly no expert on trade matters, others have pointed out in comments to Judge Greene that lifting the manufacturing constraint could promote the balkanization of U.S. equipment markets into regional cartels controlled by the respective Regional Holding Companies. Most, if not all, of the regional companies' manufacturing partners are likely to be foreign-based equipment manufacturers. The result will be to reserve large sections of the U.S. equipment market as the exclusive preserve of foreign companies. This would improve neither U.S. competitiveness nor the U.S. trade position.

Moreover, this potential recartelization of the equipment industry would occur at a time when the federal government is aggressively pressing for an opening of foreign equipment markets. Foreign governments are unlikely to be persuaded to loosen the bonds of their own countries' equipment cartels if they see the United States taking steps in the opposite direction.

Further, it is inconsistent with principles of trade policy to take steps that effectively foreclose competition in large segments of the U.S. market. Instruments of trade policy must be flexible in order to have the desired effect. A tariff, for example, can be raised or lowered as trade conditions and policy demand. The same is true for quotas, or any sanction. A green light for self-dealing, on the other hand, flashed by a merger or other joint venture is very difficult to turn off at will.

In summary, the DOJ recommendations on manufacturing may tend to worsen, not resolve, U.S. trade problems because they will reserve domestic market segments for foreign products, send the wrong signal to those foreign governments currently considering steps to liberalize market access, and institute non-tariff barriers to free trade which will be extremely difficult to remove.

SUMMARY

The importance of protecting monopoly customers from abuses of monopoly power, which prompted the line of business restrictions in the first place, remains undiminished. The conditions upon which the court based the original restrictions of the MFJ still exist. The case for elimination of these antitrust protections is simply not persuasive. In my view, the proponents of change have not met their burden of proof. Thus, it is my opinion that the restrictions on the Bell Operating Companies should not be eliminated at this time.

Thank you for your attention. I would be pleased to answer any questions.

FOOTNOTES

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[1] United States v. American Tel. & Tel. Co., 552 F. Supp. 131, (D.D.C. 1982), aff'd. sub nom., Maryland v. United States, 460 U.S. 1001 (1984).

[2] United States v. American Tel. & Tel. Co., 524 F. Supp. 1364, (D.D.C. 1981).

[3] 524 F. Supp. at 1364.

[4] 524 F. Supp. at 1372.

[5] 524 F. Supp. at 1356.

[6] 552 F. Supp. at 167-68.

[7] Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment, 4-8 (February 2, 1987).

[8] NARUC Communications Committee, "Resolution Supporting Conditions for Removal of Competitive Restrictions on Bell Operating Companies", Adopted February 26, 1987, Reported in NARUC Bulletin No. 10-1987, pages 3-5.

[9] "Summary Report on the Regional Holding Company Investigations", NARUC, Washington, D.C., September 18, 1986.

[10] Id. at 7.

[11] "Three Regional Bells Post Rise in Quarterly Net", Wall Street Journal, April 21, 1987, at 50.

[12] Supra. note 9 at 11.

[13] Id. at 12.

[14] Id. at 2 and 3.

[15] Id. at 11.

[16] NARUC Communications Committee, "Resolution Supporting Creation of Regional Oversight Committees", Adopted February 26, 1987, Reported in NARUC Bulletin No. 10-1987.

[17] Ernst and Whinney Telecommunications Group, The Telecommunications Industry in Washington State -- Market Competitiveness, Service Availability, and Cost-of-Service Methodologies, prepared for the Washington Utilities and Transportation Commission (December 1, 1985). Washington Utilities and Transportation Commission, The Annual Report on the Status of the Washington Telecommunications Industry, presented to the Washington State Legislature (January 12, 1987).

[18] Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), CC Docket No. 85-229, FCC 86-252 (June 16, 1986).

[19] Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, CC Docket No. 86-111, FCC 86-564 (February 6, 1987).

[20] Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 7 FCC 2d 384, modified on reconsideration, 84 FCC 2d 50 (1980), further modified on reconsideration, 88 FCC 2d 512 (1981), aff'd sub nom., Computer and Communications Indus. Ass'n v. FCC, 693 F. 2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983), aff'd on second further reconsideration, FCC 84-190 (May 4, 1984).

[21] Computer III Order at paras. 5-6.

[22] The first CEI plan was not filed until March 6, 1987. The plan requests authority for Bell Atlantic to offer a rudimentary Voice Message Storage service in Pennsylvania. Telecommunications Reports, p. 3 (March 9, 1987).

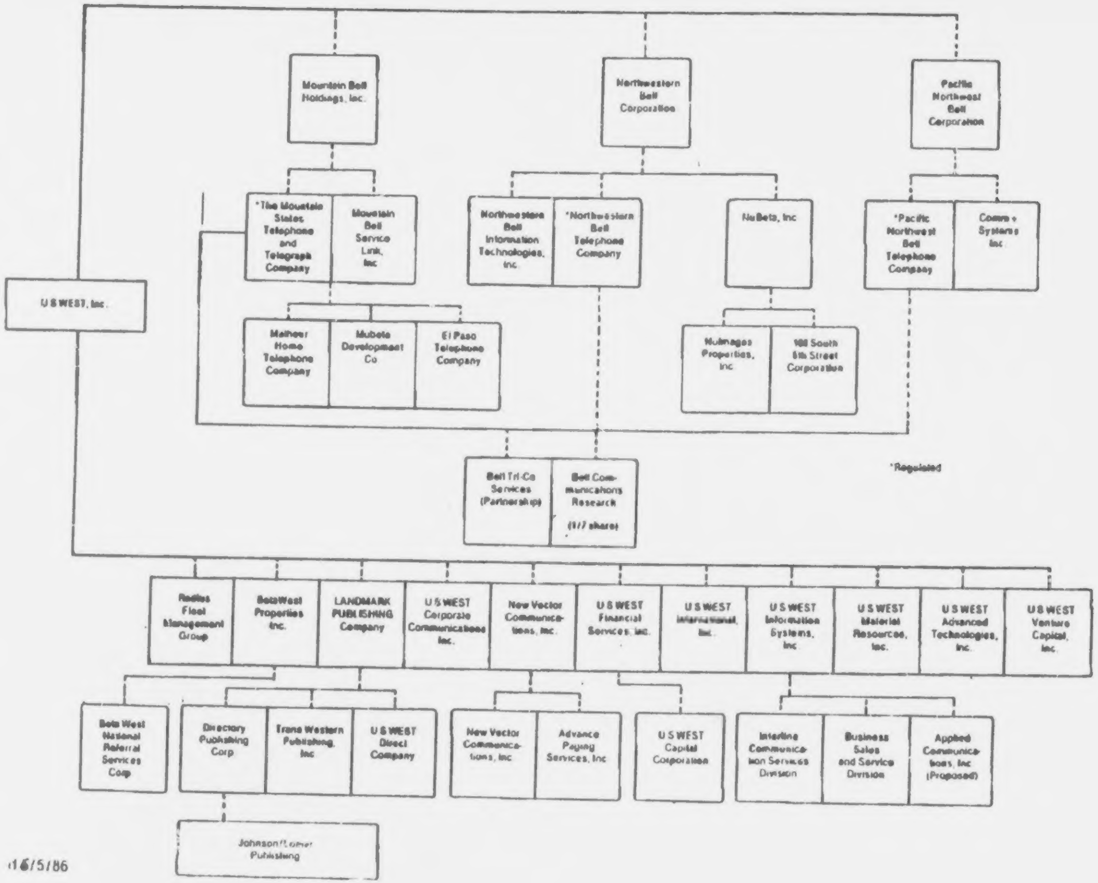
[23] Joint Cost Decision at para. 2.

[24] Petitions for reconsideration of the Joint Cost Order were required to be filed by April 6, 1987. After or in lieu of FCC reconsideration, aggrieved persons may file an appeal with a United States Court of Appeals of appropriate venue within 60 days of the release of the present order (May 5, 1987) or of a petition for reconsideration.

[25] This recommendation was not supported by one Commissioner, indicating that these issues truly are contentious.

[26] Huber Report at 1.33.

[27] Louisiana Public Service Com. v. FCC, 476 U.S. ___, 90 L Ed 2d 369, 106 S. Ct. 1890 (1986).


U S WEST, Inc.
Mountain Bell Holdings, Inc.
Northwestern Bell Corporation
Pacific Northwest Bell Corporation
*The Mountain States Telephone and Telegraph Company
Mountain Bell Service Link, Inc
Northwestern Bell Information Technologies, Inc
*Northwestern Bell Telephone Company
NuBeta, Inc
*Pacific Northwest Bell Telephone Company
Comm + Systems Inc
Malheur Home Telephone Company
Mubeta Development Co
El Paso Telephone Company
NuImages Properties, Inc
100 South 5th Street Corporation
Bell Tri-Co Services (Partnership)
Bell Communications Research (1/7 share)
*Regulated
Radius Fleet Management Group
BetaWest Properties Inc.
LANDMARK PUBLISHING Company
U S WEST Corporate Communications Inc.
New Vector Communications, Inc.
U S WEST Financial Services, Inc.
U S WEST International, Inc.
U S WEST Information Systems, Inc
U S WEST Material Resources, Inc.
U S WEST Advanced Technologies, Inc.
U S WEST Venture Capital, Inc.
Beta West National Referral Services Corp
Directory Publishing Corp
Trans Western Publishing, Inc
U S WEST Direct Company
New Vector Communications, Inc
Advance Paying Services, Inc
U S WEST Capital Corporation
Interline Communication Services Division
Business Sales and Service Division
Applied Communications, Inc (Proposed)
Johnson/Lomer Publishing

6/5/86

Senator **Metzenbaum**. Thank you very much.

I was very impressed, Ms. Nelson, with this chart that you included, and it is certainly understandable when you say that there are limitations as to what you can do.

You show on this chart that there were 37 separate corporations—maybe I am wrong by one or two, but that is an unbelievable number. And it is my understanding that U.S. West is actually not the largest of the new BOCs.

Am I correct about that?

Ms. **Nelson**. In terms of revenues. In terms, I think, of geographic territory that it serves it is the largest. In terms of revenues, I think it is not. In terms of total capitalization of the company and so on, I think that is correct.

And I should emphasize, Mr. Chairman, that that chart is a June 1986 chart.

Another problem that regulators face is that there is a great deal of churn in this industry right now. We recognize, as Mr. Rule indicated to you, that there is a great amount of change, of rapidly accelerating innovation and so on, and there also is that in corporate structure. The corporate structure of U.S. West changes, it seems, constantly. New subsidiaries are formed or folded into other subsidiaries and the like. And that just makes the job of tracking those improper cross subsidies all the more difficult.

Senator **Metzenbaum**. I use telephone service in three different states, four as a matter of fact, including the District—no, three. And, in each instance, local rates have gone up at a meteoric rate, some far, far beyond the others.

Haven't rates gone up and service gone down just about everywhere since the breakup occurred?

Ms. **Nelson**. Mr. Chairman, I think you have to take that question on almost a market-by-market basis.

I am pleased to report in Washington that we have seen very limited pressure on local rates for basic exchange services. I don't exactly know why we are so lucky, but that is the case in our State.

But I do know that the national experience is that the basic local rate for basic access and exchange services has increased dramatically. But, again, on a market-by-market basis, it is the case that long distance rates have come down. Definitely in the customer premises equipment market we are seeing quite a wide array of choices and prices for consumers.

So I think it is a mixed result that we are seeing at this point.

Senator **Metzenbaum**. Has the National Association of Regulatory Utility Commissioners participated in the case, and have you filed some document or brief with the court indicating the same position that you have taken here in opposition to the lifting of the restrictions.

Ms. **Nelson**. Well, that is something of a complicated question. The National Association has filed comments, and it is quite clear at page 8 of its comments, it did say it in Judge Greene that its recently concluded audit of the diversification by the regional holding companies has created strong incentives to subsidize competitive lines of business with revenues provided by and costs shifted to regulated utility activities. And it stated, of course, it was exactly this kind of subsidy problem which harms ratepayers of the regulated business.

However, the Commissions from the various States have all filed additional comments, and I think we do take differing positions.

The National Organization has said that this cross subsidy remains an essential problem. However, there are many of my colleagues on the NARUC Communications Committee and in the organization generally who believe that they could impose certain conditions upon the operating companies within their jurisdictions that would mitigate some of those cross subsidy problems.

So I think it is almost a State-by-State analysis one must conduct to get a general sense of the State regulators.

We in Washington, and I think I speak for all of the Western States, believe that we have a real problem with the regional holding company we regulate. And I believe all of us have filed comments with Judge Greene, or many of us have, saying we think the lifting of restrictions at this time would be premature.

Senator METZENBAUM. I guess my question is that you are appearing on behalf of your own State as well as the National Association. Is the position of the National Association against lifting the restrictions?

Ms. NELSON. It is for lifting the restrictions, but subject to certain very stringent conditions. And those conditions have been enumerated to Judge Greene. That is where that body is.

Senator METZENBAUM. Thank you very much, Ms. Nelson. We appreciate your testimony.

Ms. NELSON. Thank you.

Senator METZENBAUM. Our next panel consists of Walter Alford, Senior Vice President, Regulatory Affairs of BellSouth; John Zeglis, Senior Vice President and General Counsel, AT&T; Bert Roberts, President, MCI; and Gene Kimmelman, Legislative Director, Consumer Federation of America.

Mr. Alford, happy to hear from you, sir. You know our five-minute rule.

STATEMENTS OF PANEL CONSISTING OF WALTER H. ALFORD, SENIOR VICE PRESIDENT, REGULATORY AFFAIRS, BELLSOUTH CORP., ATLANTA, GA; JOHN ZEGLIS, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, AT&T, BASKING RIDGE, NJ; BERT ROBERTS, JR., PRESIDENT, MCI, WASHINGTON, DC; AND GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA, WASHINGTON, DC

Mr. ALFORD. Thank you, Mr. Chairman.

I represent the BellSouth Corporation and its subsidiaries. And I want to thank the Committee for allowing us to express some of our concerns about the continuation of the MFJ restrictions.

The line-of-business restrictions contained in the modification file judgment have unprecedented and pervasive anti-competitive effects. American consumers not being provided information aid services and are suffering under the burden of higher costs and outdated technology. American jobs are being lost. American competitiveness and productivity are handicapped.

After divestiture was announced, AT&T declared boldly that the restrictions on the box were not our idea. Well said, Mr. Brown.

Now, AT&T has decided to embrace the idea that was it theirs and adopt what apparently this time had only one parent. Curiously, they are joined by an old foe, MCI, once the champion of long distance competition, but which now opposes the BOCs entry into that market.

In addition, to shrinking from BOC competition in long distance, AT&T also would forever freeze out the BOCs from manufacturing telecommunications equipment. The idea that was it theirs is looking better all the time, at least to them.

Changes in markets, technology and regulation have obsolete the restrictions contained in the MFJ, and indications are that such changes will escalate. America's world leadership and respect for our innovativeness depends on an expanded role in this industry for the BOCs. Our information services marketplace in this country is lagging woefully behind France, Germany, Canada, the United Kingdom, Singapore, Hong Kong and Japan. It would be shameful if we permit this trend to continue.

It is the active participation of local companies in those countries that has created any success for their information age services. In each case, the intelligence is housed in the central office of the local telephone company. If BOCs don't bring these services to the American public, the bulk of Americans are never going to see them.

About manufacturing. Without being able to even ally ourselves with manufacturers, we are precluded from really responding to our customers. We have been approached by a myriad of domestic manufacturers with interesting proposals for business relationships, but we can't take advantage of these proposals which would create jobs and satisfy customer demand.

It is unseemly to us that the broadest possible manufacturing prohibition is advocated by a company which in recent years has curtailed operations in Louisiana, New Jersey, Maryland, Indiana, Illinois, Pennsylvania, while opening up in Taiwan, Singapore, Thailand, Spain, and it has allied itself with foreign manufacturers in countries such as The Netherlands and Italy.

The DOJ modified its original recommendation excluding inter-LATA relief except for mobile services and radio services on April the 27th. We believe, however, that we have an important role to play in this market right now. That role could be as an agent in putting customer networks together. It might be in the least cost routing. The provision of that service, least cost routing, takes some of the confusion out of shopping for long distance service, and seems to us to have a real place for the small consumer.

Since divestiture, the facts are the quality of telephone service has improved. The price of overall telephone service is down. The number of customers that can afford telephone service is up. The impact has been positive on the gross national product. The consumers have more choices.

BellSouth believes that the BOCs have played an aggressive and important role to bringing these benefits to customers, and that it makes absolutely no sense to artificially constrain the productive capacity of these companies, almost 2 percent of the total GNP in this country, from making significant contributions in other related consumer marketplaces.

There is no substantial threat nor any to competition in permitting us to participate in these related endeavors. But if we continue the BOCs to be the de jure pariahs of American industry, the American consumer and the American competitive free enterprise system will be the losers.

Thank you.

[Prepared statement follows:]

STATEMENT OF
WALTER H. ALFORD
SENIOR VICE PRESIDENT
on behalf of
BELLSOUTH CORPORATION
before the
ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS SUBCOMMITTEE
of the
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
April 30, 1987

EXECUTIVE SUMMARY

BellSouth supports modification of the AT&T consent decree to assure that all American consumers have access to today's technology and that competition, not protection of competitors, is the antitrust criterion in the global information age. The modifications recommended by the Department of Justice are in the best interest of consumers and competition. They recognize the impact of technology, changed market structures and the global nature of telecommunications competition.

Information Services

The information services restriction deprives consumers of equal access to the information age and reduces competitive opportunities for current and potential information service vendors. This restriction has had the unintended effect of inhibiting market development. Replacing the prohibition on information services with alternative regulatory safeguards will encourage new competitors to enter the information services market. Full utilization of the vast public telephone network already in place will get new services to more consumers faster and at lower costs.

Manufacturing

The manufacturing restriction prevents the Bell Operating Companies (BOCs) from participating in the development and production of technology necessary to make the "information age" an affordable reality for the majority of households and small businesses in America. Being allowed to make business judgments with respect to manufacturing and joint venturing is vital to the BOCs' ability to respond to customer desires. The restriction is directly at odds with a . national telecommunications policy of promoting consumer interests through competition. This restriction further creates disincentives for the BOCs to invest in research and development since they have no meaningful opportunity to recover their costs. These disincentives have restrained the pace of innovation and denied consumers the benefits of more cost efficient technology.

Interexchange Services

Removal of the interLATA long distance restriction is in the best interest of consumers and competition because the BOCs are the only telecommunications providers that are prevented from providing a customer's end-to-end communications needs. This restriction remains in spite of the fact that equal access has been achieved. Many customers, both rural subscribers and small businesses, are deprived of choices in selecting a long distance provider. In addition, removing the restriction will benefit consumers by positioning the BOCs to more effectively compete for large business customers who want one-stop shopping, thereby enabling the BOCs to maintain revenues necessary to keep local rates affordable. Clearly competition would be served in a market dominated today by one supplier. In any event, lifting the restriction to allow the BOCs to provide interLATA services through an interim separate subsidiary is in the public interest because it will enhance competition.

Conclusion

If the best interests of consumers and competition are to be served, in light of today's rapidly changing technology, BOCs must be allowed to compete fully and fairly in all facets of the increasingly integrated and global telecommunications market. BellSouth supports the modification of the AT&T consent decree in order to assure that all Americans have access to today's technology and that competition, not protection of competitors, is the nation's antitrust criterion. Looking backward to "yesterday's" phone system will not serve consumer needs, a competitive market, or the global information age. The public interest can only be served by meeting the telecommunications needs of today's and tomorrow's consumer through modification of the AT&T consent decree.

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I. INTRODUCTION

BellSouth welcomes this Committee's interest in modifications to the AT&T consent decree. The Department of Justice recommendations, which are now before Judge Harold Greene propose removal of the information services, manufacturing and non-telecommunications restrictions and limited relaxation of the interexchange restriction. It is essential that the recommendations be approved *now* if the "Information Age" is to be made available to all consumers and not just an economically-advantaged few.

During the Court proceeding in this matter which ultimately led to the AT&T divestiture, U.S. District Judge Harold Greene fully realized the potential and likely impact rapidly changing market conditions and technology could have on the telecommunications industry and consumers. He also recognized that restrictions in the decree were, in fact, anticompetitive. Therefore, Judge Greene adopted DOJ's proposal to undertake a triennial review of the line of business restrictions. Furthermore, he modified the decree by incorporating Section VIII(C), which provides that the decree's restrictions should be removed when there is no substantial threat to competition by BOC entry into a particular market.

This pending proceeding represents the Court's first general review of the restrictions on the BOCs in light of significant developments in the nation's telecommunications markets since the decree was entered in 1982.

The Department of Justice recommendations recognize the changed market structures, the global nature of telecommunications competition and the major impact of technological change. For these reasons and others, the DOJ has recommended outright removal of restrictions on information services, telecommunications equipment manufacturing and non-telecommunications lines of business. The Department also recommended modification of the long-distance restriction to allow BOCs to provide long-distance service outside their regions and for specialized mobile services in all areas. Under the recommendation, other long-distance services may be offered subject to certain regulatory safeguards and changes. It is BellSouth's understanding that this recommendation was modified by the Department of Justice in a motion filed with the Court on April 27, 1987.

Chairman John Dingell (D-MI) of the U.S. House Energy & Commerce Committee commented as follows on the DOJ filing: *"The recommendations represent a welcome step toward enabling the Bell Operating Companies to bring the benefits of information-age technology to as many Americans as possible. Continued imposition of current restrictions would merely reward a few powerful, vested economic interests."*[1]

The interests of consumers and the nation's development of a competitive telecommunications and information services markets will be best served by the Court's approving removal of the current decree restrictions.

Attached to this statement and made a part hereof is the BellSouth Corporation filing made in the U.S. District Court for the District of Columbia on April 27, 1987.

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[1] News Release on Department of Justice's recommendations on AT&T consent decree, February 2, 1987.

II. IMMEDIATE LIFTING OF MFJ INFORMATION SERVICES RESTRICTION IS CLEARLY IN THE PUBLIC INTEREST.

A. INFORMATION SERVICES RESTRICTION IN THE AT&T CONSENT DECREE IS OPPRESSIVE TO CONSUMERS AND AT ODDS WITH SOUND ANTITRUST POLICY.

Historically, antitrust policy in the U.S. has been crafted to preserve competition, not to protect individual competitors. Experience with the AT&T consent decree to date shows that prohibiting Bell Company entry into competitive markets in 1987 is not only at odds with this principle but is increasingly costly to consumers as well.

1. AT&T consent decree is depriving consumers of timely access to the Information Age.

Operating telephone companies owned by the seven Regional Bell Companies provide high quality local telephone service, at widely affordable rates, to nearly 80 percent of the nation's population.[2] They, therefore, represent the best, and in the case of literally millions of households and small businesses in rural and other high cost areas, the only practical source of many new information services that recent advancements in state-of-the-art technology (such as fiber optics and digital switching equipment) are now making possible.[3]

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[2] The Bell Companies are among the nation's largest firms; they serve over 95 million business and residential customers, have a combined net book value approaching $160 billion, and employ over 556,000 highly skilled Americans.

[3] See affidavit of Professor Jagdish Sheth, Attachment, BellSouth Reply Comments in U.S. vs. Western Electric et al, April 27, 1987.

Continued exclusion of the Bell Companies from information service markets will deny these consumers, including many low- and middle-income households, access to the Information Age and the promise that it holds for improving the quality of life in this country. Certain consumer groups recognize this fact and, and are recommending to Judge Greene that the information service restriction be eliminated from the AT&T consent decree. For example, in comments filed jointly by the National Consumers League and eight other consumer organizations, the Court was urged to:

> *"weigh the cost of not lifting the [information service] restriction -- the greatest of which is the continued loss of service options to the public -- against the possible risk of anticompetitive behavior.... [T]he interests of all concerned -- the information provider, the large institutional users, the telephone company and the citizen user -- are all fostered by rapid movement toward a more open and competitive information services marketplace. This cannot happen, however, until such time as the BOCs are allowed into that line-of-business, subject to appropriate [regulatory] safeguards."*[4]

2. AT&T consent decree also is denying many small businesses equal access to information services that they must have to compete with larger firms.

The information service restriction in the AT&T consent decree is also denying small businesses access to state-of-the-art telecommunications and information processing technology and services. Currently many different types of larger businesses are turning to such services in order to reduce costs, boost productivity and become more competitive overall.[5] Small businesses simply do not have the resources to buy and maintain the sophisticated customer-owned telephone and computer equipment that is required to obtain advanced information services today. Many of these services, however, could and would be available to business customers through the Bell Companies with little or no up front investment requirement were it not for LOB restrictions in the AT&T consent decree.

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[4] Joint Comments of National Consumers League, Black Citizens for a Fair Media and the Council of Churches of New York City, National Association of State Universities and Land Grant Colleges, Native American Public Broadcasting Consortium and the National Indian Youth Council, Office of Communications of the Church Federation of Greater Chicago, Consumer Interest Research Institute, Public Interest Computer Association, and the National Association for Better Broadcasting, p. 38-39.

Immediate Bell Company relief from information service restraints in the AT&T consent decree, therefore, should be of particular interest to the Subcommittee since continued denial of these services to small businesses only benefits their larger competitors and could eventually lead to more concentrated industry structures throughout the economy. Public policies that handicap small business competitively also will erode the nation's entrepreneurial incentives, skills, and resources at a time when these assets are sorely needed to replace U.S. jobs that many major corporations are losing to foreign competitors (or are exporting to off-shore production facilities) and to combat growing trade imbalances.[6]

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[5] See, for example, M. Porter and V. Miller, "How Information Gives You A Competitive Advantage," Harvard Business Review, July-August 1985.

[6] For example, since divestiture, AT&T has either ceased or substantially cut back production at no fewer than six plants nationwide (e.g., Shreveport, LA; Kearney, NJ; Baltimore, MD; Indianapolis, IN; Chicago, IL; and, Allentown, PA), while opening four major new production facilities off shore (i.e., Taiwan, Singapore, Thailand and Spain). According to trade press accounts, AT&T's decision to relocate much of its production capacity abroad has not only resulted in the loss of at least 10,000 high quality U.S. jobs, but also means that the vast majority of AT&T microelectronic production (i.e., computer chips) will be abroad. See, for example: "AT&T Will Invest in Manufacturing Facility in Taiwan," Asian Wall Street Journal, July 11, 1983; "AT&T Renames Facility; Plans Computer Distribution Strategy in Thailand," The Report on AT&T, May 6, 1985, p. 10-11; "AT&T to Make Home Phones in Singapore," The Wall Street Journal, July 8, 1985, p. 4; "AT&T Launches Microcircuit Joint Venture in Spain," Communications Week, April 28, 1986, p. 51.

B. THE DOJ IS ENTIRELY CORRECT IN RECOMMENDING THAT THE COURT REPLACE THE INFORMATION SERVICE RESTRAINT WITH ALTERNATIVE REGULATORY SAFEGUARDS.

In light of concerns raised above, it is understandable that the DOJ, in its first triennial review of the AT&T consent decree, is recommending that the Court remove the information service restraint and rely upon comparably efficient interconnection (CEI) or open network architecture (ONA), cost allocation, and related regulatory safeguards to protect against any residual risks. The DOJ has recognized that the FCC and many state regulatory commissions will actively encourage new competitors to enter the information service market, thereby stimulating customer demand for these new services and enhancing their profit potential.[7] Senator Albert Gore (D-TN), commenting on the proposed safeguards, said

> *"There are those who honestly believe that there is no sure-fire way to protect consumers and competitors from BOC cross-subsidies or anticompetitive behavior; that the only real protection is an outright prohibition against BOC entry into new business areas, or arms-length separate subsidiaries. I do not accept that view. The problems is not the lack of protections, it is the ability and willingness to enforce protections."*[8]

BellSouth shares this belief and will submit an ONA implementation plan to the FCC early next year. With the availability of ONA, all information service providers will be afforded access to local telephone network facilities, under the same terms and conditions that apply to the Bell Companies themselves, or their affiliated information service providers. ONA, therefore, will be to the information service industry what equal network access is to the long-distance service providers -- a realistic condition for full and fair competition. Meanwhile, CEI, the service-specific equivalent of ONA, will provide interim competitive equality. In that sense, replacing information service restrictions with an affirmative commitment on the part of the Bell Companies to provide information service suppliers equal network access also complements sound antitrust policy.

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[7] Of the sixteen state public service commissions that recently filed comments on the DOJ's proposal to modify the AT&T consent decree, twelve expressed support for replacing the information service restriction with regulatory safeguards: California, Florida, Illinois, Michigan, Minnesota, Missouri, New York, Pennsylvania, Vermont, Virginia, West Virginia, and Wisconsin.

[8] Speech before the conference on "Communications Policymaking in the 100th Congress," February 4, 1987.

1. Even AT&T agrees that the information restraint should be replaced with alternative safeguards.

AT&T, major information service vendors, and nearly all major telecommunications users agree that the information service restriction must go. Suppliers and customers alike are beginning to appreciate just how detrimental the restraints have been to the development of a robust and profitable information service market in this country. The recent growth in availability of, and demand for, information services in other parts of the world contrasts sharply with the U.S., where progress has been much slower. As Congressman Tom Tauke (R-IA) observed recently:

> *"We're now in a situation where people in other countries have more telecommunications services available to them than we have in America. From a consumer perspective there are compelling reasons to look into lifting the*

restrictions. More competition will give all of us better services for less money."[9]

The following table from the Geodesic Network, 1987 Report on Competition In the Telephone Industry by Peter Huber illustrates the extent of foreign information service offerings.[10]

INFORMATION SERVICES OFFERED BY FOREIGN TELEPHONE COMPANIES

	CANADA	FRANCE	JAPAN	UNITED KINGDOM	GERMANY	HOLLAND	BOCS	MFJ
INFORMATION ACCESS/ RETRIEVAL	Y	Y	Y	Y	Y	Y	N	N
MESSAGING	Y	Y	Y	Y	Y	Y	N	N
COMPUTING SERVICES	Y	Y	Y	Y	?	?	N	N
TRANSACTIONAL SERVICES	Y	Y	Y	Y	Y	?	N	N
PERSONAL/ ENVIRONMENTAL	N	?	Y	?	Y	?	N	N

Y = Yes N = No

2. Information service relief will not only make many new services available to consumers, but also help keep basic local telephone rates widely affordable.

Since AT&T's divestiture three years ago, many of the Bell Companies' potential competitors have been vociferous in opposing relaxation of line-of-business restrictions in the decree. In support of their self-serving opposition they allege that, in the absence of such constraints, the Bell Companies would cross subsidize information and other competitive services with revenues earned from "captive" local telephone customers.

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[9] Speech before the conference on "Communications Policymaking in the 100th Congress," February 4, 1987.

[10] See Peter W. Huber, THE GEODESIC NETWORK: 1987 Report on Competition in the Telephone Industry, (Washington DC: Government Printing Office, 1987), Table IS.20, p. 6.44.

Information service relief will benefit all consumers, including those basic telephone customers that might make little or no use of information services. Senator Gore also observed that

> *"In addition to the obvious efficiencies and customer opportunities that would occur if the BOCs were to provide various information services, I am attracted to the possibility of new tariffed revenues to help offset rising costs of local service."*[11]

The threat of cross subsidization and misallocation of costs are of major concern to telecommunications policymakers precisely because many local network facilities are used in common to provide both regulated and non-regulated services. While this situation complicates life for the regulator, it also creates opportunities to reduce rates charged for all types of exchange services, BOC entry will encourage greater use of embedded network plant and spread the fixed costs of those facilities over a broader customer base.

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[11] Speech before the conference on "Communications Policymaking in the 100th Congress," February 4, 1987.

3. The BOCs should not be arbitrarily prohibited from providing electronic information services to the consuming public.

The DOJ recommendation includes removal of the prohibition against the BOCs providing electronic publishing. We agree that this restriction is illogical and in direct conflict with efforts to promote competition and enhance and increase consumer options. To deny consumers the ability to communicate with each other through speech and other means, and for the BOCs to communication with their subscribers, is a clear denial of the right of free speech, is therefore in contradiction of the parties' constitutional rights, and is clearly anticompetitive. To restrict the BOCs in this fashion is to thwart the principle of diversity of information, contrary to the way the ANPA would apply the principle.

III. THE MANUFACTURING PROHIBITION IS ANTICOMPETITIVE AND HARMFUL TO CONSUMERS.

A. THE MANUFACTURING PROHIBITION IS MAKING IT EXTREMELY DIFFICULT FOR THE BELL COMPANIES TO GET THE TECHNOLOGY THAT THEY NEED TO BRING THE INFORMATION AGE TO 100 MILLION HOUSEHOLDS.

Entry of the Bell Companies into the information service market holds great promise for competition and consumers alike. Full utilization of the vast public telephone network already in place will get new services to more parts of the country faster and at lower cost than could be accomplished through any other electronic distribution medium. Freeing the Bell Companies to provide information services, however, is not enough. They must be free to participate in the development and production of state-of-the-art technology if they are to help make the Information Age an affordable reality for the great majority of households and small businesses in this country.

BellSouth's interest in relief from the manufacturing restrictions should not be viewed as an indication of a pressing desire to actually build telecommunications equipment. Rather, as John L. Clendenin, Chairman and CEO of BellSouth, recently stated in an interview with the editors of Telephony magazine:

> *"At the very minimum, we need to be able to ally ourselves with the manufacturing process so that we have an ownership interest, a proprietary interest [in the development of new technology].*
>
> *"That does not say that we would rush out and build a lot of factories. As a matter fact, we don't have any manufacturing expertise per se. But what it does say is that we need to be allowed to make business judgments with respect to the manufacturing process that is vital to our continuing ability to respond to the desires of our customers".*[12]

1. The combined effect of the information services and manufacturing prohibitions have created competitive incentives for the Bell Companies to rely less heavily on domestic equipment suppliers, much to the benefit of foreign manufacturers.

The Bell Companies need to participate in the development, if not the production of exchange network technology that will be used to provide information and other telecommunications services locally, because AT&T, and other full-service vendors in the U.S., also compete with local telephone companies. Such full-service vendors have the potential to "manage" the flow of new technology to those exchange carriers that rely heavily on them for equipment.

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[12] Telephony, April 20, 1987, p. 32.

By controlling the flow and, hence, the availability and timing of new technology, vertically integrated full-service vendors can give their own telecommunications service subsidiaries a competitive advantage over the regulated exchange carriers, in local service markets. Many new information services features now being developed for business and residential customers are dependent upon upgrades that equipment manufacturers make to the *proprietary* software operating systems that control digital telephone switches. Rather than risk being held "hostage" to software development and release schedules of existing vendors the Bell Companies have been forced to consider other manufacturers -- that do not compete for local exchange business -- to provide them with all-important digital switching technology. *This is why the combination of the information and manufacturing restrictions in the AT&T consent decree also has added greatly to the nation's trade problems in telecommunications equipment.*

BellSouth's recent decision to place a major order for central office equipment with Stromberg-Carlson is a good illustration of this phenomenon. BellSouth's decision in this particular instance turned on the need to upgrade central office equipment in relatively small exchanges (largely rural areas) using technology that would enable the BellSouth Companies to offer advanced telecommunications services to these communities. Stromberg-Carlson was eventually selected to provide this equipment because it was one of the very few central office equipment manufacturers who expressed a willingness to customize switching equipment for BellSouth's particular needs.[13]

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[13] See CommunicationsWeek, op cit.

Here again, Chairman Clendenin's recent remarks in Telephony magazine illustrate the practical and clearly harmful consequences of the manufacturing prohibition to local telephone customers:

> *"Frankly, we have been very frustrated by the lack of responsiveness by a number of manufacturers in designing futuristic switches to serve small communities. We have conducted an aggressive search of American manufacturers and overseas manufacturers to find one that would really respond.*
>
> *"We think of bringing the information age to small town America. We really worked hard to find a manufacturer, who would take what we needed in the way of a [switch] design and respond to it.*
>
> *"The other manufacturers' tendency was to say 'Look, we have a product line, take what we have and make it work' -- which isn't really responsive at all.*
>
> *"We are now in a position to deal with one manufacturer [Stromberg-Carlson] who will produce the kind of machine we're talking about."*[14]

Given this situation, BellSouth submits that if national telecommunications policy is to truly promote consumer interests, that policy must not preclude the Bell Companies from developing new technology and services, whether they do so individually or jointly with U.S. or foreign manufacturers. The manufacturing prohibition in the AT&T consent decree is directly at odds with this principle because it severely limits options for the Bell Companies to update local network capabilities in ways that assure consumers in rural areas and small businesses (or even larger ones) have modern services available to them at reasonable rates. Only through their ability to develop hardware and software for application in *local* telephone networks, and often selectively for a specific rural community or business customer, can BellSouth and the other Bell Companies meet emerging needs of *all* of its customers in *all* of its markets at widely affordable rates.

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[14] Telephony, April 20, 1987, p. 32.

Local telephone customers should not be required to make do with second best technology -- or an even worse scenario, to be burdened with, high cost, obsolete equipment that precludes local telephone companies, and other competing information service vendors, from ever providing information services -- simply to protect certain unresponsive domestic equipment manufacturers from other more responsive foreign competitors. BellSouth can envision no reasonable basis of support for banning seven of the nation's leading telecommunications companies from competing in telecommunications markets both here and abroad.

2. The combination of information service and manufacturing prohibitions also have had the anticompetitive effect of eliminating incentives for the Bell Companies to invest in R&D.

It is axiomatic that "[a]n established company, which, in an age demanding innovation, is not capable of innovating, is doomed to extinction."[15] Certainly, as the telecommunications industry enters the Information Age, the Bell Companies, individually and collectively, will find it necessary to innovate if they are to stay competitive with AT&T, IBM and other full-service vendors. The Bell Companies' individual abilities to compete will become increasingly important as these full-service vendors step up their efforts to vertically integrate "backward" into exchange service markets as they attempt to compete more effectively for the accounts of those large business customers that put a premium on "one stop shopping."[16] These full-service suppliers have a competitive advantage because, unlike Bell Companies, they are legally permitted to design, install and service integrated telecommunications/information processing systems in ways that satisfy the particular needs of large corporate users. In *today's* technology-intensive local telecommunications marketplace, innovation of new information services and equipment features is simply a competitive necessity.

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[15] Peter F. Drucker, Management: Tasks and Responsibilities. (New York: Harper, 1974)p. 786.

However, in 1985 the Regional Bell Companies' consolidated annual expenditures on R&D represented only 1.3 percent of their total annual sales or about $1,445 per employee. Average R&D spending by all U.S. industries in 1985 amounted to 3.1 percent of sales ($3,758 per employee) or about 2.5 times Bell Company averages. In contrast, major "high tech" firms in the U.S., including AT&T and IBM, are devoting anywhere from 5 to 8 percent of their sales to R&D (i.e., $6,000 to $9,000 per employee), or from three to six times Bell Company commitments.

Major discrepancies between R&D expenditures by the Bell Companies and their major competitors is an unmistakable, albeit unforseen, "by-product" of the manufacturing and information service restrictions in the AT&T consent decree. As long as the BOCs are precluded from bringing new equipment and/or information service features to the market directly, incentives to invest in R&D will remain acutely limited, because the Bell Companies will have no meaningful opportunities to recover their costs.

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[16] In his report, THE GEODESIC NETWORK, DOJ consultant Peter Huber correctly observes, on the basis of a wealth of factual analysis, that "[b]y all market indications, corporate consolidation [a.k.a. vertical integration] is absolutely essential [to effective competition in global telecommunications product and service markets], whatever happens to the MFJ. Maintaining competition among the vertically integrated providers is therefore the surest protection against Orwellian concentrations of social power." p. 1.10

The ramifications of the LOB restraints on R&D spending are all the more serious because of their effects on consumers and competition. Disincentives to invest in R&D, for example, deny consumers the benefits of more cost efficient technology -- and therefore the potential for lower rates and/or improvements in service diversity and quality -- that greater commitments to R&D should bring about.

Failure of the Bell Companies to spend competitively on R&D, also may well be having a detrimental effect on new entry into U.S. telecommunications equipment and related software markets by start-up and other smaller domestic firms. In Chairman Clendenin's words:

> *"The truth is there are dozens, maybe hundreds of American manufacturers who would be greatly interested in entering joint ventures with us to develop products that they cannot currently develop because of a lack of resources. We have probably, with the current restriction, perpetuated the dominance of a few large manufacturers in this country at the expense of a lot of would-be, entrepreneurial manufacturers who have not had the resources to develop products, to conduct research and development".*[17]

3. LOB relief is critical to U.S. competitiveness in global telecommunications markets.

Finally, and as noted above, LOB restraints embodied in the AT&T consent decree have, and will continue to, hurt U.S. competitiveness and trade in increasingly global markets.[18] This is due, in large measure, to the fact that R&D spending by the Bell Companies is less than half of what might be expected in the absence of the LOB restrictions. This lack of commitment to R&D spending has restrained the pace of innovation and, thus, detracted from the superiority of American technology. In addition, the AT&T decree has created positive incentives for the BOCs to substitute foreign-made products for equipment produced by AT&T Technologies and IBM; again, the basis is the dual role each has as a supplier and competitor of the Bell Companies. These incentives have not only aggravated recent trade problems in communications equipment markets, they also are allowing major European and Japanese manufacturers to gain a strong foothold in American markets; a presence that foreign vendors must have if they are to compete globally on a long-term basis. These complex and wide-ranging ramifications of the LOB restrictions embodied in the AT&T consent decree are clearlv detrimental to U.S. trade interests. In BellSouth's view adverse trade consequences present substantial justification for replacing the LOB restraints with less costly regulatory safeguards.

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[17] Telephony, April 20, 1987, p. 32.

[18] In 1975, for example, total combined exports and imports (i.e., total trade) of telecommunications equipment accounted for 5.3 percent of total shipments in the U.S. Last year, the ratio of total trade to total value shipped in the U.S. had risen three-fold to 15.2

The same is true of the harm that the prohibitions have caused to American consumers. As the National Telecommunications and Information Administration (NTIA), U.S. Department of Commerce correctly and succinctly observed in it recent analysis of the trade effects of the AT&T consent decree:

> *"The Bell Companies. in the aggregate. represent half of the U.S. telecommunications industry's human and financial resources.... [T]urning around the present adverse trade situation will require mobilizing all of our communications industry resources. The Bell Companies can make a difference. and they ought to be afforded*

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percent. Similarly, between 1982, the year AT&T's divestiture was announced, and 1986, U.S. trade in telecommunications equipment (SIC 3661) declined from a $200 million surplus to a $1.3 billion deficit. By comparison during this same time period annual U.S. trade balances for all goods and services fell from -0.04 percent to -2.6 percent of GNP.

> *freedom [from LOB restrictions] to do so.*"[19]

And as Congressman Al Swift (D-WA) recently stated in the House of Representatives:

> *". . . for me, the most important reason to lift the restrictions is the potential benefits for local service ratepayers. First, when the basic telephone system is put to greater use, the fixed costs are spread over more users and, with new services sharing costs, it takes pressure off local rate increases. Second, there are many services that are not offered today-or are offered only at prices that many potential users cannot afford -- but which could be offered at affordable rates if we allow efficient use of the existing network. Third, because the Bell Operating Companies make up on-half of the domestic telecommunications industry, we assure the United States remains competitive in world markets by introducing seven significant players in the economy."*[20]

IV. ALLOWING THE BELL COMPANIES TO PROVIDE INTERLATA LONG-DISTANCE IS CRUCIAL TO FAIR COMPETITION AND CONSUMER CHOICE.

A. BARRING THE BELL COMPANIES FROM THE INTERLATA LONG-DISTANCE MARKET DENIES MILLIONS OF CONSUMERS THE BENEFITS THAT THE BREAKUP OF THE BELL SYSTEM WAS SUPPOSED TO BRING ABOUT.

AT&T's divestiture has provided increased options, choices and better prices for many

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[19] NTIA Trade Report, Feb. 4, 1987, p.124.

[20] Statement in the House of Representatives to introduce "The Telecommunications Policy Act of 1987," April 9, 1987.

Americans, including many local telephone customers served by BellSouth.[21] However, not all consumers have benefited equally from the competition that the breakup of the former Bell System was intended to make available to the *entire* public. Indeed, in rural America several million households and many hundreds of thousands of small business customers have benefited very little from AT&T's divestiture and long-distance competition.

Rapidly changing circumstances within long-distance service markets also suggest that entry by the Bell Companies would pose no potential threat to competition. As a case in point, AT&T's major long-distance competitor, MCI, recently came out in support of FCC proposals to replace AT&T rate-of-return regulation with some form of price regulation (e.g., price "caps" on MTS and possibly WATS) on the grounds that the interstate service market is now sufficiently competitive to begin the transition to total deregulation. If this is so, it should also follow that entry by the Bell Companies into the interLATA market will afford no substantial threat to competition, so long as they continue to comply with equal access obligations mandated by the Court and new FCC cost allocation guidelines that will remove any legitimate concern over cross subsidization.

Given Bell Company compliance with these safeguards only two conclusions can reasonably be drawn about the practical effects of not removing the interLATA prohibition from the AT&T consent decree. First, if the interLATA market is as robustlv competitive as AT&T and MCI apparently believe it to be, then entry by the Bell Companies should provide absolutely no potential threat to competition; their market entry *may* provide a competitive option in those rural and other high cost markets that the other common carriers (OCCs) elect not to serve.

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[21] Since AT&T's divestiture, the quality of local service in BellSouth's nine state area has increased, as evidenced by steady reductions in customer complaints, service outages, related equipment failures, and virtually every other performance indicator that the BellSouth Companies routinely track. Equally important, the average BellSouth customer paid *less* per month for the same level of local and long distance telephone service in 1986 than in 1984. On average, the cost of telephone service has declined in the BellSouth region in the last three years, because local rate increases during that period (largely as a result of pro-competitive regulatory decisions) have been more than offset by lower equipment prices and reduced long distance rates (also a result of competition).

Second, if AT&T's current market share (75-85 percent, depending on the estimate) continues to remain unaffected by the availability of equal access to the OCCs, AT&T's position in the interLATA market could be considerably more dominant than it would have public policymakers believe. This situation also provides ample justification for interLATA relief since it suggests that the Bell Companies may well represent AT&T's only meaningful rival for the future.

B. INTERLATA RELIEF WILL BENEFIT ALL CONSUMERS, INCLUDING THOSE LOCAL TELEPHONE CUSTOMERS WHO MAKE LITTLE OR NO USE OF LONG-DISTANCE SERVICE.

Eliminating the interLATA prohibition from the AT&T consent decree will do far more than promote competition among long-distance carriers, and lower prices for long-distance service. Local telephone subscribers also will benefit because, in the absence of this particular restriction, BellSouth and other Bell Companies will be far better positioned to compete with AT&T, IBM, GM/EDS and a growing number of other major full-service vendors for large business customer accounts; accounts that represent a very substantial share of local telephone revenues that would have to be made up if they are lost to competitors.

It also is in this context that Peter Huber's analysis of trends toward growing vertical integration in the telecommunication/information processing industries is so important to the debate over the future of LOB restraints. Dr. Huber correctly observes that as the network becomes more intelligent and as switching and transmission capacity become more prolific and cheaper, traditional boundaries between basic local telephone service, long-distance, information services and network and customer premises equipment (CPE) will meld into a single integrated market structure. This process is already well on its way for large business customer, and will accelerate with the introduction of new technologies such as Integrated Services Digital Network (ISDN) architectures and continuing rapid growth in fiber optic network transmission facilities.

While the Bell Companies have no assurances of success in this new environment, one thing is virtually certain: if consumers in general, and local telephone customers in particular, are to benefit from the Information Age, the Bell Companies must be allowed to compete fully and fairly in *all* facets of the increasingly integrated telecommunications equipment and service markets, including interLATA toll.

V. CONCLUSION

Changing technology is dictating changes in the way people and nations live and work. Our nation's ability to be competitive in the global Information Age rests, in large part, with the BOCs' ability to be an active participant in the development and deployment of new products and services.

The current AT&T consent decree review process, crafted by Judge Greene, is a major step in assuring our nation's ability to be an active participant in the Information Age. BellSouth, and others, through Court removal of current restrictions and Bell Company entry as competitive alternatives, can assure that all Americans will share in these new services. Modification will also assure that antitrust standards of promoting competition rather than protecting selective competitors will be the criterion.

Consumers have received the benefits of increased choice and options over the past several years. In the early years it caused some confusion and concern as consumers learned a new procedure of choice for equipment and long-distance services. But they have learned well, and all surveys of quality of service demonstrate that telephone service is better than ever by every standard of measurement. Local PUC surveys, FCC analyses and long-standing telephone company measurement systems all show improved service. Local rates have increased far less than the dire predictions of doubling or tripling testified before Congress a few years ago. Further, consumers in BellSouth territory are making choices in equipment and long-distance services that have resulted in *lower total* telephone costs today than they had in 1984. When consumers have options, they make decisions that meet their price and service needs.

Consumers and competition are the winners when the decree is further modified to assure that our nation's policy is not directed backwards to yesterday's "phone service" but directed forward to the technologies of tomorrow's changing telecommunications products and services.

The DOJ recommendations recognize the need to eliminate several restrictions and revise others to meet "today's" and "tomorrow's" needs of the American consumer. BellSouth supports removal of the line of business restrictions from the AT&T consent decree to meet the needs of both consumers and competition.

ATTACHMENT

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
)
Plaintiff,)
)
v.) Civil Action No. 82-0192
)
WESTERN ELECTRIC COMPANY,)
INC., and AMERICAN TELEPHONE)
AND TELEGRAPH COMPANY,)
)
Defendants.)

MOTION TO ACCEPT PLEADING

BellSouth Corporation ("BellSouth"), by its attorneys, hereby moves for leave to file its Response to Comments on the Justice Department Recommendations and Memorandum in Support of Motion for Relief from Section II(D) of the Modification of Final Judgment ("Response and Memorandum", filed herewith). As grounds in support of this Motion, BellSouth states as follows:

1. In an Order dated March 25, 1987, this Court ordered that all Motions requesting relief from Section II(D) of the Modification of Final Judgment ("MFJ") be filed no later than April 27, 1987.

2. This Court had previously ordered (Order filed March 19, 1987) that Responses to Comments on the "Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment" be filed no later than April 27, 1987.

3. The importance of the issues raised by the voluminous comments filed March 13, 1987 required thorough and careful response. Similarly, the importance of the relief requested in BellSouth's Motion for Relief from Section II(D) of the Modification of Final Judgment required careful analysis and support.

4. In an effort to minimize the overall length of BellSouth's submissions, its arguments and analyses have been combined within the Response and Memorandum.

5. Although BellSouth has attempted to be as brief and succinct as possible, the Response and Memorandum exceeds forty-five pages. Thus, this pleading may not conform to the requirements of Local Rule 108(e) in its present form.

6. Accordingly, in order to permit BellSouth to present arguments appropriate to the importance of the issues raised by its Motion, and to the quantity and variety of the issues raised by other parties and limited intervenors, BellSouth respectfully requests leave to file the attached pleading notwithstanding any limitation contained in Local Rule 108(e).

7. The relief requested herein is identical to that granted by the Court to Pacific Telesis Group in its Order dated April 22, 1987.

WHEREFORE, BellSouth Corporation respectfully requests that this Court grant the instant Motion to Accept Pleading. An appropriate Order is attached.

Respectfully submitted,

BELLSOUTH CORPORATION

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Its Attorneys

April 27, 1987

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

WESTERN ELECTRIC COMPANY, INC., and AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

Defendants.

Civil Action No. 82-0192

ORDER

Upon consideration of the BellSouth Corporation Motion to Accept Pleading filed April 27, 1987, it is hereby

ORDERED that the Motion be, and it hereby is granted.

Harold H. Greene
United States District Judge

Dated:

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
)
Plaintiff,)
)
v.) Civil Action No. 82-0192
)
WESTERN ELECTRIC COMPANY, INC.)
and AMERICAN TELEPHONE AND)
TELEGRAPH COMPANY,)
)
Defendants.)

BELLSOUTH CORPORATION'S MOTION FOR RELIEF UNDER SECTION II(D) OF THE MODIFICATION OF FINAL JUDGMENT

BellSouth Corporation, by its attorneys, hereby moves, pursuant to Section VIII(C) of the Modification of Final Judgment ("MFJ"), that the Court

(1) remove the interexchange telecommunications services restriction contained in Section II(D)(1) of the MFJ with respect to:

(a) mobile telecommunications services, including cellular, conventional mobile radio, paging, marine mobile, air-to-ground, and similar specialized telecommunications services;

(b) all interexchange telecommunications originating outside the area served by the BellSouth operating telephone companies;

(c) all interexchange services for interexchange telecommunications of data;

(d) all interexchange services for telecommunications originating within any private telecommunications network;

(e) all other interexchange services provided through one or more entities that are separate from the BellSouth operating telephone companies, if such entities obtain their own debt financing on their own credit such that no entity affiliated with BellSouth will guarantee the debt in a manner that would permit a creditor, on default, to have recourse to the stock or assets of any BellSouth operating telephone company.

(2) remove the information services restriction contained in Section II(D)(1) of the MFJ;

(3) remove Sections II(D)(2) and VIII(A) of the MFJ;

(4) remove Section II(D)(3) of the MFJ.

The ground for this Motion, as more fully set forth in the attached "BellSouth Corporation Response to Comments on the Justice Department Recommendations and Memorandum in Support of Motion for Relief from Section II(D) of the Modification of Final Judgment", is that the relief from Section II(D) requested in this

Motion is warranted under the standard set forth in Section VIII(C) of the MFJ. An appropriate order is attached.

Respectfully submitted,

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April 27, 1987

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. WESTERN ELECTRIC COMPANY, INC. and AMERICAN TELEPHONE AND TELEGRAPH COMPANY, Defendants.	Civil Action No. 82-0192

ORDER

Upon consideration of the BellSouth Corporation Motion for Relief Under Section II(D) of the Modification of Final Judgment, and the various responses and replies thereto, it is hereby ordered and adjudged that the Motion be, and it is hereby, granted.

Harold H. Greene
United States District Judge

Dated:

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
)
Plaintiff,)
) Civil Action No. 82-0192
v.)
)
WESTERN ELECTRIC COMPANY, INC.,)
and AMERICAN TELEPHONE AND)
TELEGRAPH COMPANY,)
)
Defendants.)

BELLSOUTH CORPORATION RESPONSE TO COMMENTS ON THE JUSTICE DEPARTMENT RECOMMENDATIONS AND MEMORANDUM IN SUPPORT OF MOTION FOR RELIEF FROM SECTION II(D) OF THE MODIFICATION OF FINAL JUDGMENT

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April 27, 1987

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
)
Plaintiff,)
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WESTERN ELECTRIC COMPANY, INC.,)
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BELLSOUTH CORPORATION RESPONSE TO COMMENTS ON THE JUSTICE DEPARTMENT RECOMMENDATIONS AND MEMORANDUM IN SUPPORT OF MOTION FOR RELIEF FROM SECTION II(D) OF THE MODIFICATION OF FINAL JUDGMENT

BellSouth Corporation ("BellSouth"), by its attorneys, hereby responds to comments on the Justice Department's Recommendations concerning the line-of-business restrictions contained in the Modification of Final Judgment. Many of the comments provide substantial additional support for the Recommendations. This Response addresses several issues that have been raised by AT&T and by limited intervenors in opposition to some aspects of the Department's Recommendations.

I. THE PARTIES' POSITIONS REQUIRE THE INFORMATION SERVICES RESTRICTION TO BE TERMINATED WITHOUT NEED TO APPLY THE SECTION VIII(C) STANDARD

All parties to this proceeding agree that the Court should accept the Justice Department's recommendation to eliminate the information services restriction contained in Section II(D)(1).[1] Where the Government recommends the modification or termination of a consent decree, and where the parties to the original proceeding consent to that recommendation, the courts have accepted the government's proposal unless there is evidence of corrupt misfeasance by the government -- a circumstance that has not even been alleged in this case. *A fortiori*, where a decree itself contains a modification standard intended to be less stringent than in the ordinary case, the consent of the parties mandates acceptance of such a recommendation. Accordingly, the Justice Department recommendation to eliminate the information services restriction should be implemented without delay.

The legal standard applicable to consented modifications of antitrust consent decrees was recently stated and applied in *United States v. National Finance Adjusters, Inc.*, 1985-2 Trade Cas. (CCH) ¶ 66,856 (E.D. Mich. 1985). The government and the defendants in that proceeding agreed to modify an earlier consent decree entered in settlement of a Sherman Act prosecution. In the face of objections to the modification expressed by various non-parties the court stated:

> Where the parties consent to modification of the final judgment, this court's scope of review is limited to a determination of whether such modification is in the public interest. *United States v. Swift & Co.*, 1975-1 Trade Cas. (CCH) ¶ 60,201, at 65,702-73 (N.D. Ill. 1975). Furthermore, the Justice Department has wide discretion in controlling government antitrust litigation, and this court should not

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[1] Some of the limited intervenors oppose this recommendation. Their arguments are addressed *infra*.

> second guess the wisdom of its acceptance of a consent decree or a modification thereof unless there is a claim of bad faith or malfeasance on the part of the government in so acting. Sam Fox Publishing Co. v. United States, 366 U.S. 683, 689 (1961). 'The Attorney General is the representative of the public interest in antitrust cases brought by the Government. . . .' Control Data Corp. v. International Business Machines Corp., 306 F.Supp. 839, 845 (D. Minn. 1969), aff'd sub nom. Data Processing Financial & General Corp. v. International Business Machines Corp., 430 F.2d 1277 (8th Cir. 1970)

Id. at p. 64,248. The Department of Justice has consistently adhered to its position that this is the appropriate rule to apply to consented modifications.[2] As it points out, "literally hundreds" of judicial orders have applied this standard to modification or termination of antitrust decrees by consent of the parties.[3]

There are ample grounds for elimination of the information services restriction under any of the legal standards that might be argued to be applicable to this Decree -- "changed circumstances", Section VIII(C), or the "public interest". However, because there is unanimous consent among the parties to the Justice Department's recommendation, and because there has been no allegation that the Department of Justice has acted corruptly or in bad faith, no additional delay in eliminating this prohibition is warranted.

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[2] See, Memorandum of the United States in response to Motion of the Greyhound Corporation and GLI Holding, Inc. to Terminate the Final Judgment Herein, at 9-13, United States v. Greyhound Corp., No. 57 C 1107, (N.D. Ill. March 17, 1987).

[3] Id. at 13 n.*.

II. THE SECTION VIII(C) STANDARD APPLIES TO THE JUSTICE DEPARTMENT'S RECOMMENDATIONS

AT&T and several of the limited intervenors have attempted to restrict or reinterpret the standard of Section VIII(C). Such attempts involve at least one of the following incorrect assertions:

(1) A legal standard other than that contained in Section VIII(C) applies to the Recommendations;

(2) The Section VIII(C) standard is equivalent to the Swift[4] standard for contested decree modifications opposed by the government;

(3) Relief under the standard contained in Section VIII(C) requires elimination of any BOC market power in the provision of local telephone services;

(4) The Department of Justice improperly applied Section VIII(C) by "balancing" anticompetitive effects against efficiencies or other public benefits;

(5) The Department of Justice bears the burden of proof.

Each of these assertions rests on fundamental errors of law and all must be rejected by this Court.

A. The Four Corners Rule Requires Application of Section VIII(C) to the Justice Department's Recommendations

An antitrust consent decree must be interpreted according to the ordinary meaning of its terms. This canon of decree construction was explicitly adopted by the Supreme Court in United States v. Armour & Co., 402 U.S. 673, 681-82 (1971), and has become known as the "four corners" rule. United States v. ITT Continental Baking Co., 420 U.S. 223, 238 (1975). The four corners rule has been applied to the MFJ, and it applies to

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[4] United States v. Swift & Co., 286 U.S. 106 (1932).

Section VIII(C). United States v. Western Electric Co. (Bell Atlantic), 797 F.2d 1082, 1089 (D.C. Cir. 1986). The meaning of Section VIII(C) cannot possibly be misconstrued: it applies to requests for relief from the restrictions contained in Section II(D). There can be no further useful debate on this point.

B. The Swift Standard Cannot be Incorporated Into Section VIII(C)

Because the Decree contains a provision expressly applicable to requests for relief from Section II(D), that provision (Section VIII(C)) governs the Justice Department's Recommendations under the four corners rule. AT&T and some of the limited intervenors state or suggest that the decree modification standard applied in United States v. Swift & Co., 286 U.S. 106 (1932), should or must be read into the Section VIII(C) standard.

Such arguments assume two basic forms in the comments on the Justice Department Recommendations. AT&T asserts that, despite the explicit language of Section VIII(C), Swift applies only to a limited range of restrictions under Section II(D). Teleconnect goes even farther, asserting that Section VIII(C) incorporates the Swift standard. Neither position has merit.

Because Section VIII(C) makes no reference either to Swift or to the "changed circumstances" standard imposed in that case, the four corners rule precludes the use of that test. If there were any doubt of this construction of Section VIII(C), it would be eliminated by reference to this Court's decision requiring that Section VIII(C) be incorporated in the Decree. The Court made it clear at that time that incorporation of Section VIII(C) in the Decree was essential to avoid the application of Swift. United States v. Western Electric Co., et al., 552 F. Supp. 131, 195 n. 266 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983).

When the original Decree was proposed, the Court recognized that the line-of-business restrictions contained in Section II(D) are inherently anticompetitive because they necessarily exclude new market participants. The Court also recognized that the legal standard for contested modification of antitrust consent decrees can be stringent. Swift applied a relatively strict standard to such a proposed modification, contested by the government, of the Meatpackers Decree. The Court appreciated that if that standard were applied to motions for relaxation of Section II(D), some parties could prevent the BOCs from entering new lines of business based on their competitive self-interest, rather than upon an objective assessment of antitrust considerations.

Therefore, the Court determined that a decree containing the inflexible and comprehensive entry limitations proposed by the parties and subject to contested modification only under stringent legal standards would not have been in the public interest. The Court required incorporation of a more lenient modification standard in Section VIII(C) in order to avoid a conclusion that entry of the Decree might have been contrary to the public interest. To avoid this result, the Court accepted the Justice Department proposal for triennial review of Section II(D). Id.

AT&T argues that the so-called "core" prohibitions stand in a different posture from other prohibitions contained in the Decree. This peculiar gloss upon Section VIII(C) has no legal basis. The language of Section VIII(C) makes no distinction among the various Section II(D) restrictions. Moreover, neither the Court nor any of the parties recognized or discussed any such distinction when the proposed Section VIII(C) was under consideration.

This is not to say that every different line of business will be appropriate for BOC entry under precisely the same conditions. Section VIII(C) provides a legal standard for removal of the restrictions in Section II(D). The risks and opportunities of competitive entry could vary among different proposed lines of business. Indeed, the variation in competitive conditions in different lines of business was the fundamental basis for the Court's rejection of the original parties' "monopoly quarantine" theory. The Court recognized that anticompetitive potential varied depending on the technical, economic and regulatory circumstances affecting each new market and the environment for BOC participation in that market.

C. Elimination of Local Telephone Service Market Power is Not a Prerequisite to Section VIII(C) Relief

Neither the language nor the circumstances surrounding the incorporation of Section VIII(C) in the Decree suggest that elimination of any alleged local exchange service monopoly power was to be a prerequisite for relief from Section II(D), whether such relief involved "core" prohibitions or any other. Acceptance of this argument would condemn the BOCs to stand on the "shrinking island" of landline local exchange service, unable to step off into other lines of business until the moment that the local exchange monopoly vanished. Again, the language of Section VIII(C) is patently inconsistent with the "shrinking island" theory. The Court's decision to permit entry of the MFJ, as well as its contemporaneous and subsequent references to this provision, compel the conclusion that any factor relevant to the balancing of competitive risks and opportunities may be weighed in applying the pragmatic balancing test of Section VIII(C). Disappearance of the shrinking island is not a prerequisite to relief from Section II(D).

The Court has consistently stated that relief from Section II(D) would be appropriate upon the occurrence of structural change in the markets that the BOCs seek to enter. United States v. GTE Corp., 603 F. Supp. 730, 742-743 n. 53 (D.D.C. 1984). These repeated references to structural change in other markets flatly contradict any argument that relief from Section II(D) is to be controlled solely by reference to competitive conditions in the local exchange service market. The Court's grant of numerous waivers of Section II(D) in both communications-related and non-communications markets, despite the lack of findings concerning local exchange market power or its erosion, merely confirm that the Section VIII(C) standard does not depend exclusively or even predominantly on any such findings. Indeed, the Court has granted the overwhelming majority of line-of-business waivers without even considering the degree of market power held by the BOCs with respect to any local exchange telephone service.

D. The Justice Department Correctly Applied Section VIII(C)

Several of the limited intervenors accuse the Justice Department of "balancing" potential anticompetitive effects of BOC entry into new markets against potential economic efficiencies or other public benefits. *See, e.g.*, comments of General Electric Communications & Services, New York Clearing House Association. These statements are supported with only isolated citations to irrelevant portions of the Recommendations, laced together to produce an incorrect representation of the government's approach. The Justice Department stated clearly at the outset of its Recommendations that it would adhere to the accepted standard of Section VIII(C), which looks to potential competitive effect only, and the Recommendations are faithful to this approach.[5]

E. The Government Does Not Bear the Burden of Proof

Several of the limited intervenors assert that the government bears the burden of proof with respect to requests filed under Section VIII(C) for relief from Section II(D). Such assertions are without authority and should be rejected. Recognizing the strong presumption of legitimacy that attaches to the antitrust enforcement decisions of the Justice Department, Section VIII(C) refers only to the burden of proof that the BOCs must meet in order to be relieved of the line-of-business restrictions. Numerous waivers have been granted by the Court without any intimation that the burden placed on the BOCs by Section VIII(C) also attaches to the government.

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[5] At the other extreme, some limited intervenors fault the Justice Department for ascribing insufficient weight to a variety of public interest factors. Since it is clear that the Justice Department's Recommendations are in the public interest, there is no need to consider the precise weight that should be assigned to such factors.

III. THE AT&T MOTION SHOULD BE DENIED

BellSouth pointed out in its initial Comments that consideration of AT&T's Motion would raise serious questions regarding statutory and constitutional limitations on the role of an independent regulatory commission like the FCC in public Sherman Act enforcement proceedings. Even MCI, an interexchange carrier that has alleged interests in this proceeding closely resembling those of AT&T, concurs with BellSouth's view that the existing statutory allocation of antitrust enforcement authority precludes consideration of the extraordinary relief requested by AT&T. MCI comments at 88-89 and nn. 265, 266.

A decision rendered since BellSouth's Comments were filed casts additional doubt on the merits of AT&T's Motion. On March 24, the U.S. Court of Appeals for this Circuit implicitly approved District Judge Hogan's ruling that a challenge to the constitutionality of the exercise of law enforcement responsibilities by independent agencies, whose officials are not subject to the President's direct supervisory control, raises "a serious and substantial issue of considerable public importance". Ticor Title Ins. Co. v. Federal Trade Commission, 625 F. Supp. 747, 751 (D.D.C. 1986) (dismissing constitutional challenge as unripe), aff'd on other grounds without majority opinion, 1987-1 Trade Cas. (CCH) ¶67,490 (D.C. Cir. 1987). This decision merely underscores what has been adequately demonstrated in previous submissions; the AT&T Motion raises difficult issues of both statutory and constitutional dimension, and should not be granted absent a compelling need.

Even if AT&T were correct that a modification of the procedures would serve the goals of administrative convenience, this could hardly justify the extraordinary step of transferring jurisdiction from the Justice Department to an independent executive-branch agency. As demonstrated in the comments, however, AT&T's position is clearly incorrect. The waiver procedure has had no identifiable effect on the Justice Department's Decree enforcement activities.

Although the foregoing considerations should be sufficient to dispose of the AT&T Motion, it also bears emphasis that the FCC now has stated that it "emphatically does not want" the waiver screening responsibilities that AT&T seeks to have the Court assign to it.[6] This adds the complication that even if the Court were to issue an order further involving the FCC in line-of-business waiver proceedings, the Commission apparently would not accept that responsibility. This would raise further issues regarding the Court's authority to compel the FCC to expend resources for such an effort.

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[6] Response of Federal Communications Commission as Amicus Curiae in Opposition to AT&T's "Motion to Modify the Procedures Applicable to Proceedings Under Section VIII(C)", at 4.

The constitutional, statutory, and prudential considerations just outlined do not preclude the Court from receiving the views of the FCC as amicus curiae concerning waiver matters, nor do they prevent the Court from basing its own specific waiver decisions on valid actions taken by the FCC under its own statutory authority. Thus, for example, the Court could properly rule that BOC entry into a new line of business is permitted under Section VIII(C) because FCC regulation has eliminated any alleged risk of discriminatory network access or cross-subsidy. In exercising its decision-making authority under the Decree, the Court takes account of all relevant facts and circumstances. The relevant circumstances will often include lawful Commission action taken pursuant to the Communications Act. Decisions of this Court that reflect FCC rules and decisions do not, however, constitute an exercise of Decree authority by the Commission.

Because AT&T's request for modification of waiver procedures is without merit and the relief it requests may be unlawful, the AT&T Motion should be denied.

IV. THE INFORMATION SERVICES RESTRICTION SHOULD BE REMOVED UNDER THE SECTION VIII(C) STANDARD. THE BOCS CANNOT USE THEIR MONOPOLY POWER TO IMPEDE COMPETITION

The Department's recommendation to remove the Decree's prohibition on BOC provision of information services elicited comment from over 75 parties. The comments reflect an underlying recognition that the prohibition has prevented wide introduction of innovative services, and that in light of the conditions in the markets at issue, non-structural safeguards would be effective in eliminating any alleged risks of cross-subsidization and discrimination. Support for removal of the restriction comes from a broad base of commenters -- current and potential users (consumer groups, banks, insurance companies and individuals), regulatory bodies, information service providers, trade organizations, manufacturers, and other telephone companies.

The comments reflect broad recognition of the benefits of BOCs' providing information services. Businesses, when speaking as consumers, support removal of the restriction: they recognize that removal will afford more choices, intensify price competition, and reduce their costs of arranging for service. Regulators argue that information services will permit the BOCs to obtain new revenues from their networks with little additional cost. The potential for more efficient and economical provision and more rapid deployment of information services, for fuller utilization of existing network capacity, and for stimulation of further advances in the nation's telecommunications network is also recognized. In short, many commenters see removal of the prohibition as the way to bring the Information Age to all segments of society -- not only by direct BOC provision of information services, but also by freeing BOCs to construct an infrastructure that will permit users to obtain convenient and inexpensive access to many independent information services vendors.

The Videotex Industry Association argues that the slow growth of videotex in the United States has been due, in part, to the lack of "the necessary telecommunications infrastructure."[7] It points out that the prohibition has kept BOCs from "providing the infrastructure's key components." BOC provision of these components is essential to the development of "a mass market for videotex services in the home and office."

United Press International sees the freeing of the BOCs as an important step in opening the industry to greater competition. Even the American Newspaper Publishers Association (ANPA) concedes that BOCs should provide "network improvements which can enhance the ability of electronic publishers to provide public service."[8]

Others cogently argue that the prohibition has harmed consumers by retarding the development of technology and by contributing to the growing gap between those with access to information and those without. It has reinforced the notion that "the elderly, the minority population, the low income and other vulnerable populations do not 'need, want or require' access to more advanced technology."[9] It has limited access to information services to large-scale users and has generally narrowed the scope and diversity of information sources and services.

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[7] Some commenters challenge the Justice Department's conclusions about the growth and availability of information services in the United States compared to other nations. These comments gloss over the important distinction between the existence of information services and their accessibility and affordability. It cannot be denied that most existing information services are beyond the reach of most Americans.

[8] A coalition of consumer groups (National Consumers League, *et al*.) urges removal of the prohibition, based on public benefits from BOC provision of such an infrastructure. The coalition also supports the direct provision of information services by BOCs for the benefit of consumers. Their premises are (1) that there is pent-up consumer demand for easily accessible and economical information services and (2) that BOC provision of those services is vital to satisfy that demand by direct and indirect means.

The relationship among the information services restriction, the nature of supply, demand and technology, and the antitrust policies embodied in the MFJ are established in the Affidavit of Jagdish N. Sheth (Appendix B). Briefly, Dr. Sheth demonstrates that the fundamental economic characteristics of the information services market may properly be analogized to those of the typical large-scale shopping mall: the economies of shared infrastructure from the suppliers' side and the economies of transactional convenience on the buyers' side create a uniquely efficient marketplace in the true sense of that word. Dr. Sheth's economic analysis and his review of evidence from other non-BOC telecommunications experience clearly establish that the local exchange is the only logical point for the emergence of that "information mall" within the United States' telecommunications system. If this development is not permitted to occur, the consequences for the antitrust policy objectives embodied in the Decree will undoubtedly be negative -- perhaps to a degree that will be devastating in the long run.

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[9] Comments of National Consumers League, et al., p. 12.

Opposition to the Department's recommendation comes primarily from two areas: those potential competitors who fear that new competition will adversely affect them, and those who fear the alleged potential for cross-subsidization or discrimination.

A. Opposing Commenters Exaggerate the Potential for Discriminatory Abuse of Monopoly Power

As demonstrated by the comments of consumers, suppliers, and regulators, regulatory safeguards, the antitrust laws and practical considerations are more than sufficient to avoid abuses that might injure competitors in the information services markets. The market for information services is now served primarily by well-established competitors whose size, sophistication and experience make them unlikely candidates for anticompetitive attacks. The detail of some of the comments demonstrates that businesses in this category are vigilant observers of the marketplace and its regulators. They have demonstrated their willingness and ability to detect and seek remedies for anti-competitive practices. This degree of awareness and assertiveness is itself a powerful deterrent to anti-competitive conduct in information services markets. The seven regions have demonstrated their willingness to compete directly against each other, and each would serve as an additional "watchdog" of the practices of the others. The existence of seven new competitors will also facilitate the detection of questionable competitive practices by allowing each BOC to serve as a benchmark for the others.

The BOCs have little capability for anti-competitive behavior in any event. First, they have no advantage in the provision of content-based services that are characteristic of the "high-end" market.[10] Having been totally excluded from such markets by the Decree, the BOCs have no usable assets, customer base, or experience with such services. The BOCs would enter this market from a standing-start position.[11] Their monopoly power in local service transmission would confer upon them no competitive advantage in the content-generation activities that are an especially important factor for success in this market.[12]

Second, access by users to "high end," content based information services is typically obtained via the same dial-up or private line facilities used by other customers on a tariffed basis for routine exchange and exchange access services. Thus, it is difficult to identify -- let alone discriminate against -- non-BOC customers or to cross-subsidize these services.

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[10] "High end" services are generally those with high unit costs (e.g., in excess of $10 per hour) that, primarily because of price, are available as a practical matter only to those customers with a high willingness-to-pay threshold.

[11] The BOCs do have directory assistance and classified directory data bases that may be usable.

[12] In response to a claim of a copyright infringement, Donnelley Information Publishing, Inc. has made a claim that Southern Bell Telephone and Telegraph Company impeded Donnelley's ability to publish yellow pages in Miami, Florida. Southern Bell has denied this claim and the case is now before the Southern District of Florida on motions for summary judgment on copyright and antitrust issues.

Similar considerations govern the assessment of any alleged competitive risk in the "low end"[13] market. The same access facilities used by high-end customers are also used by low-end customers. The chance of identifying or discriminating against "disfavored" entities is therefore equally remote. As in the high-end market, the emergent low-end markets (such as protocol conversion and alarm services) are populated by large, sophisticated and experienced firms such as Telenet, Tymnet, ADT, and Honeywell. These market participants assure intense scrutiny of BOC behavior and prompt challenge to any questionable conduct. Such vigilance will effectively deter any anti-competitive behavior _ab initio_.

Some of the opposing limited intervenors object to inherent advantages that they perceive the BOCs to have because of their size and scope. Such characteristics are not necessarily advantages, however, since optimal firm size and scope depend on a variety of market and technical characteristics. Moreover, inherent advantages deriving from these characteristics are neither unfair nor illegal. _Berkey Photo, Inc. v. Eastman Kodak Co._, 603 F.2d 263 (2d Cir. 1979), _cert. denied_, 444 U.S. 1093 (1980). Without a specific basis for prediction of future anti-competitive effect, these matters are irrelevant under the Section

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[13] "Low-end" services are generally those "information services" with low unit costs (_e.g._, protocol conversion, energy management, home banking and shopping, alarm services) that are perceived as having little value in relationship to the underlying service.

VIII(C) standard. United States v. Western Electric Co., No. 82-0192, slip op. at 10 (D.D.C. Feb. 26, 1986) (approving Pacific/CI acquisition).

In short, no segment of the information services market provides any opportunity for abuse of monopoly power as a result of BOC entry. Any professed concerns are simply unsupported speculation. Numerous avenues of legal redress are available to any party who may be aggrieved by any future BOC behavior. These include the traditional state and federal antitrust and unfair competition remedies, Decree prohibitions on discrimination, and state and federal regulations. There are significant practical impediments to any BOC use of alleged monopoly power. Particularly when coupled with legal and regulatory safeguards -- as they will be -- the incentive and the ability to engage in improper behavior are trivial at best.

B. The FCC's Safeguards Adequately Address Cross-Subsidy and Other Concerns of Opposing Commenters

1. BOC compliance with the FCC's Computer III and Cost Separation rules is a precondition to their integrated provision of information services

Some consumers and regulators have qualified their support for removal of the information services restriction by identifying a need for regulatory supervision of the use of regulated assets in unregulated businesses. This, however, is an active regulatory issue that will continue to receive intensive public and industry attention.

Although the characteristics of supply, demand and technology place significant limits on the ability of BOCs to misallocate costs, the FCC has adopted additional safeguards to further constrain any such possibility. These rules require separation of the costs of regulated telephone service from the costs of nonregulated activities,[14] and allocation of each type of cost to its respective type of service. The FCC has also adopted the *Computer III* rules. For an interim period, these rules will provide limited alternatives to the safeguards of the FCC's *Computer II* rules, which permit BOCs to provide enhanced (information) services only through fully separate subsidiaries.[15]

Some commenters incorrectly suggest that removal of the information services prohibition would immediately free the BOCs to provide information services as an integrated part of their regulated operations. According to the *Computer III* rules, however, the BOCs will not be released from the structural separation requirements of *Computer II* until both the *Cost Separation* rules and the *Computer III* rules are implemented. Moreover, information services cannot be provided on this basis until after public comment and FCC review and approval of BOC implementation plans.[16]

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[14] Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, FCC 86-564 (released Feb. 6, 1987) (Cost Separation Order).

[15] 47 C.F.R. §64.702.

[16] Cost Separation Order at ¶¶222 *et seq.*; Computer III, at ¶¶190 *et seq.*, 2220.

Most of the opposing limited intervenors do not question the goals of these rules or their basic structure. They argue instead that the rules are not fully developed, have not been implemented, or have not already been proven effective. Commenters who urge the Court to take a wait-and-see attitude toward the new rules are really asking to retain the prohibition. The FCC is embarked on a deliberate course that will allow it to scrutinize BOC proposals for compliance and to test those new rules before complete elimination of structural separation. Until implementation of Open Network Architecture, new services will be permitted only after the FCC has determined that Comparably Efficient Interconnection is available.

Continuation of the information services prohibition necessarily presumes that the FCC will repudiate its stated intention to implement and enforce these rules. Relief from the present prohibition will permit the FCC to implement its program. There is no basis to assume that the FCC will reverse the longstanding interpretations of the Communications Act that form the basis for its approach to enhanced services.

In adopting the Computer III rules, the FCC is building on its acquired experience with the development and implementation of effective non-structural safeguards that have elements of Comparably Efficient Interconnection. The FCC has already approved and Southern Bell has already implemented a plan for the unseparated provision of certain protocol conversions.[17] This experience demonstrates both the Commission's resolve to ensure that useful services are delivered in an open competitive environment and the ability of the BOCs to comply with FCC mandates to achieve that end.

2. The Computer III rules eliminate any substantial possibility of discrimination

Opponents of the Department's recommendation generally express the same concerns about the potential for BOCs to discriminate against competing providers of information services: quality and pricing of interconnection, quality of maintenance and installation, development of network standards, and use of customer proprietary network information.[18] These concerns are at the heart of the interconnection requirements and other non-structural safeguards adopted by the FCC. The following summary of the FCC's safeguards demonstrates how they effectively address the concerns of opposing limited intervenors.[19]

a. Open Network Architecture (ONA) and Comparably Efficient Interconnection

Open Network Architecture requires that the basic service functions utilized by a BOC to provide enhanced services will be made equally available to BOC customers and competitors. BOC network design must adhere to those basic FCC requirements.[20] The determination of future network design requires the involvement of standard-setting organizations and a wide variety of other industry participants and observers who are now involved in the ONA development process. Only after the concerns of these participants have been addressed will specific network design implementation be possible. Finally, FCC approval will be a prerequisite for a finding of BOC compliance with FCC's ONA rules. With this path already established by the Commission, competitive concerns are certain to be thoroughly addressed.

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[17] Petition for Waiver of Section 64.702, File No. AAD 5-1230, Memorandum Opinion and Order, Mimeo 3489 (released April 1, 1986).

[18] The cross-subsidization issue is discussed below at pages 25 to 27.

[19] A more comprehensive summary of these safeguards is contained in Appendix A, attached hereto.

Where a BOC seeks to provide an enhanced service without structural separation prior to approval of an ONA plan, it must demonstrate compliance with the FCC's Comparably Efficient Interconnection requirements. Such a compliance showing will be service specific and must establish that the BOC offering will be made under circumstances in which the same goals as Open Network Architecture have been achieved: the BOC must offer to others without discrimination the basic service functions that it uses to provide its own integrated enhanced service. The standards require both technical and administrative equivalence.[21] Quarterly reports to the FCC are required, so that the Commission can ensure uninterrupted BOC compliance with CEI requirements and conditions.[22]

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[20] Computer III Order at ¶¶214-222.

[21] Computer III Order at ¶¶ 154-156.

b. Other Non-Structural Safeguards

As a supplement to CEI and ONA, the FCC requires the BOCs to implement additional non-structural safeguards of three basic types: 1) allocation of joint and common costs; 2) nondiscriminatory disclosure of network information; and 3) nondiscriminatory access to customer proprietary network information (CPNI). Noncompliance with any of the regulations applicable will expose the party involved to an array of remedies including, if necessary, the re-imposition of structural safeguards.[23]

(1) Network Information Affecting Interconnection

The BOCs are required to disclose technical information about the introduction of new services or network changes affecting the interconnection of any enhanced service at the make/buy point, but not later than six months prior to the introduction of the new service or network change. This obligation accrues at the time that the BOCs and any enhanced service affiliate begin joint planning, research, or development of enhanced services.[24]

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[22] FCC News, Report No. DC-872 (March 26, 1987).

[23] Computer III Order at ¶225.

[24] Computer III Order at ¶¶252-253.

(2) Customer Proprietary Network Information (CPNI)

The BOCs are required to provide customers with "the right to direct that their CPNI be withheld from BOC enhanced services personnel, and/or be released to other enhanced services vendors." They also must notify multi-line business customers of their CPNI rights every year.[25] Because unaffiliated enhanced services vendors are BOC customers, they may direct that their own CPNI be withheld from the BOCs' enhanced services personnel.

3. The Cost Separation Rules eliminate any substantial possibility of cross-subsidization

One of the key additional safeguards adopted in the Computer III Order was the requirement for the development and implementation of procedures to allocate properly the respective costs of regulated and unregulated services.[26] Although the FCC had not completed its work on such procedures when it adopted the Computer III Order, it has now adopted and released its Cost Separation Order. That Order had been adopted, but not released, when the Department was required to file its Recommendations. Based on the information then available, the Department tentatively concluded that "the rules will require unregulated activities to bear all costs attributable to those activities plus an allocated share of true joint or common costs, i.e., costs that would have been incurred even if only the regulated services were provided. . . ."[27]

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[25] FCC News, Report No. DC-872 (March 26, 1987).

[26] Computer III Order at ¶234. Taking a statement of the FCC out of context, MCI contends that the FCC's new accounting rules are not intended to protect competition (MCI Comments at 59-60). The FCC's statement was, in fact, made in the context of justifying its allocation of more costs to nonregulated activities than are necessary to avoid anticompetitive results. Cost Separation Order at ¶¶109-111. MCI's contention is contradicted by the FCC's unambiguous assertions of its intent to guard against anticompetitive cross-subsidization. See, e.g., Computer III Order at ¶234.

Although opponents of the Department's recommendation criticize the Department for relying on the Cost Separation Order before its official, final release, it is clear now beyond question that the FCC's direction remains consistent with its announced intention in the Computer III Order, just as the public and the Department were entitled to assume it would. The Order imposes accounting procedures for the identification and recording of costs directly attributable to the provision of unregulated services, including information services, and further provides for the allocation of common costs. The allocation of jointly used central office equipment, outside plant, and other associated expenses will be based on forecasts of relative use. The result of such an allocation is to assign substantially more costs to unregulated activities than would be necessary to satisfy even the most stringent antitrust standards. See MCI Telecommunications Corp. v. American Tel. & Tel. Co., 708 F.2d 1081, 1116 (7th Cir. 1983); Northeastern Telephone Co. v. American Tel. & Tel. Co., 651 F.2d 76, 88 (2d Cir. 1981).

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[27] Recommendations at pp. 145-146, n. 289. See also Huber Report at pp. 6.39-6.40.

MCI contends that the new rules "do not significantly depart from concepts that the FCC has tried in the past . . . " (p. 60). This statement is misleading. While the new rules reflect a fully distributed cost methodology (FDC) like the FCC has used in the past, the similarity ends there. The FCC's past use of FDC was for setting specific rates for various regulated services. The objective of the new rules, however, is the allocation of costs attributable to services offered beyond the Commission's ratemaking jurisdiction. Their purpose in this context is to assure that unregulated assets and operations cannot be financed with regulated revenues (i.e., rates). The rules clearly accomplish this important but less complex objective.

A number of opponents of the Department's recommendation argue that the FCC does not have the resources to enforce the Cost Separation rules. The FCC has, however, designed the new rules to be largely self-enforcing, thus minimizing the need for such resources. For instance, one of the Commission's principal requirements is that unregulated activities be charged tariff rates for tariffed services. Enforcement of this requirement is accomplished by simply comparing two numbers (tariff rate and actual charge). Also, the allocation methods prescribed give the BOCs a strong incentive to identify as many directly assignable costs as possible. The FCC has also reduced its own resource demands by adopting independent audits as another primary enforcement tool. The independent auditors must attest (1) that the cost system in place reflects the cost manual requirements of the BOC and (2) that the cost allocations performed in accordance with that system are the product of accurate methods.

C. Both the "Diversity Principle" and the First Amendment Require That the Information Services Restriction be Lifted

Several commenters argue that a so-called "Diversity Principle" requires continuation of the information services prohibition -- at least to the extent necessary to keep the BOCs out of electronic publishing and cable television services. With few exceptions, this "Diversity Principle" is relied upon by those engaged in the cable television business or in electronic publishing. Often such commenters have at least a de facto monopoly in the markets they serve, as described by the Motion Picture Association's comments. A principle formulated and relied upon only when consistent with protection from legitimate competition should be accorded little weight.

BellSouth agrees that editorial diversity is a goal consistent with the public interest and the First Amendment. There is no evidence, however, that a total ban on electronic speech by the BOCs has fostered diversity. Indeed, the evidence is to the contrary.

Although it imposed a total ban on the provision of information services (including electronic publishing) by the BOCs, the Court did not find that any entity included within the former Bell System had ever attempted to restrict the speech of any of its customers or competitors. The Court found no fault with the accuracy of any information published by the former Bell System. Indeed, the Court found that the information services that had been provided by the former Bell System had not resulted in any "significant adverse consequences." 552 F. Supp. at 185 n. 223.

The Court's total exclusion of the BOCs from electronic publishing[28] contradicts the fundamental First Amendment prohibition against prior restraints of speech. The right to speak encompasses the right to participate in all forms of speech, subject only to reasonable regulation as to time, place and manner of the noncommunications aspects of such speech. See Metromedia Inc. v. City of San Diego, 453 U.S. 490 (1981); United States v. O'Brien, 391 U.S. 367, 377 (1968); Pacific West Cable Co. v. City of Sacramento, 1986-2 Trade Cas. (CCH) ¶67,244 at p. 61,247 (9th Cir. 1986).

Rather than engaging in "regulation" of the Regional Holding Companies' right to originate information for electronic publication, the Court has imposed a total prohibition on such speech. This prohibition is improper because it is, on its face, an invalid prior restraint of speech -- not a "narrowly tailored means" of serving a compelling interest. The Court's concern is with alleged monopoly power, not the quality of the speech. The remedy (if any is required) is to impose safeguards to assure equal access, not a flat prohibition of First Amendment activity by the BOCs.

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[28] 552 F. Supp. 190, 239. The Court's definition of electronic publishing is very broad, and includes "news, business and financial reports, editorials, columns, sports, features and electronic advertising." The means of transmission include "pay television, radio and television broadcasting and electronic publications which appear either by audio means, on video screens or in print form." Id. at 181 n. 208.

No instance can be found in which a court has approved a flat prohibition on such a broad spectrum of clearly protected speech for reasons totally unrelated to the potential harmful content of that speech. The classic prohibitions on prior restraint articulated in Near v. Minnesota, 283 U.S. 697 (1931), remain the law. The electronic publishing ban, like the other information services restriction, has served only to inhibit the development of electronic publishing. In any event, these sweeping prohibitions reach well beyond the scope of governmental regulation permitted by the First Amendment. The Court's remedy far exceeds the scope of any alleged anticompetitive threat.

D. Conclusion

It is clear from the comments that the restriction on BOC provision of information services is limiting the development and availability of services demanded by the public. The market circumstances now prevailing severely limit any competitive risk of BOC entry. The FCC recognizes both the realities of the information services market and the strong public demand for these services. It has created standards and procedures to address even the most speculative fear of adverse consequences. Under these circumstances the Court is not justified in retaining a prohibition that itself encroaches on fundamental rights.

As explained above, the consensus among the parties regarding the information services restriction eliminates the necessity for application of the standard contained in Section VIII(C) of the Decree. If that standard is applied, however, it becomes clear that market circumstances, technical developments, regulatory safeguards, and a variety of other factors are sufficient to justify removal of the restriction.

The revolutionary changes in the telecommunications industry produced by the MFJ itself have combined with the foregoing developments to create a fundamentally different set of circumstances in which the MFJ restrictions must be evaluated. Under these conditions, the professed concerns regarding alleged risks of anti-competitive conduct and improper cost-shifting have been "attenuated to a shadow". The stagnation of the American information services market, particularly in comparison with the explosive growth of such services in areas where similar prohibitions do not exist, demonstrate that in this respect at least the MFJ has become "an instrument of grievous wrong." Accordingly, under any potentially applicable legal standard, the information services restriction should be removed.

V. THE PROHIBITION AGAINST MANUFACTURING SHOULD BE REMOVED. SUBSTANTIAL REGULATORY AND MARKETPLACE CHANGES HAVE OCCURRED SINCE THE MFJ WAS APPROVED

The comments filed in response to the Justice Department Recommendations strongly support the government's conclusion that the manufacturing prohibitions contained in the Decree[29] should be removed. The comments reveal considerable agreement among various state regulators, the FCC, consumers, and some manufacturers that this prohibition is unnecessary. Much of the criticism of this recommendation relies on either of two theses: (1) the Court should protect incumbent manufacturers from competition by the BOCs, and (2) U.S. foreign trade would be injured by BOC affiliation with offshore manufacturers. Equipment purchasers and manufacturers alike support removal of the manufacturing restriction. Purchasers such as United Press International expect removal of the restriction to increase competition, simplify procurement of telecommunications services and increase the pace of innovation in the development of such services. Manufacturers such as David Systems, Stantel Telecommunications, Inc., Novell, Inc., and Ericsson North America, Inc., rely on similar observations to support removal of the restriction.

Removal of the manufacturing prohibition would result in a significant increase in research and development investment by the BOCs. It would also enhance the BOCs' ability to provide customers with the benefits of equipment-based and technology-driven service improvements. It would permit more rapid and efficient development of new technology by creating a more direct interplay between the needs and preferences of users and the capabilities and resources of suppliers and researchers.

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[29] MFJ sections II(D)(2) and VIII(A).

Currently, the BOCs are often relegated to buying "off the shelf" equipment, even when they recognize clear benefits that would be obtained by improvements to such equipment. By eliminating the possibility that BOCs will either perform or finance such improvements in response to even obvious needs, the prohibition eliminates business opportunities and reduces both efficiency and customer options. Like the other MFJ restrictions, the ill effects of this market distortion fall disproportionately upon the unsophisticated, the isolated, and the less well-heeled, since these are the customers whose circumstances allow them fewer options.

If the BOCs are allowed to manufacture, they will be able to more readily guide research and development efforts toward technologies that can be provided through their own networks. Since at least two of the larger manufacturers of telecommunications equipment are competitors of various customer services offered by the BOCs, their incentives to develop technologies for BOC use are considerably reduced. (Huber, p. 14.11, n. 53)

While opposing commenters describe several concerns, none justifies retention of the restrictions. Some commenters provide only thinly-veiled pleas for protection from legitimate competition.

A. BOC Cross-Subsidy of Manufacturers is Not a Realistic Possibility

Several commenters (USTSA, p. 20-22; AT&T, p. 85; NATA, pp. 33-34) voice concern over potential BOC cross-subsidization of affiliated manufacturers. This concern ignores significant market development since the Decree was approved in 1982. The presence of experienced, vertically-integrated multinational enterprises in manufacturing -- a marketplace well beyond infancy -- renders trivial the possibility of improper BOC cross-subsidization of manufacturing ventures.

At the time the Decree was approved by this Court, the evidence before it represented a small set of "episodes" gleaned from experience, now at least a decade old, when Western Electric dominated production and supply of most telecommunications equipment employed in the United States. Western Electric's position within the same corporate structure as the former Bell System operating companies gave rise to allegations of anticompetitive conduct and cross-subsidies. The current presence of large, vertically integrated competitors in virtually every part of the equipment markets substantially reduces the ability of the BOCs to engage in cross-subsidization similar to that alleged against AT&T.

As the FCC observes, entry by the BOCs into manufacturing will be subject to substantial federal regulatory constraints. The FCC's recently-released joint cost accounting plan is specifically designed to allocate costs attributable to regulated and unregulated BOC enterprises. Not only will the BOCs be required to observe these additional regulations, but they will also continue to be subject to pervasive regulation as common carriers, further limiting the potential for cross-subsidization of unregulated activities.[30]

State regulatory commissions will continue to review BOC purchasing practices. As Dr. Huber found, state commissions have historically scrutinized such practices in order to ensure that rates for regulated services do not reflect inflated equipment investment. Moreover, state and federal rate regulation eliminates excess profits that might be used to subsidize unregulated activities. (Huber, p. 14.17). State commissions have access to BOC information concerning network equipment purchases. Additionally, procurement activities of the various BOCs are routinely used as benchmarks for the evaluation of the practices of others. (*See*, *e.g.*, Huber, p. 15.10)

B. Discriminatory Use of Customer Proprietary Network Information is Prohibited by Regulation

The FCC's current rules require that, upon customer request, the BOC make customer proprietary network information (CPNI) available to competing vendors under the same terms and conditions as it is to a BOC's own CPE personnel.[31] Thus CPNI available to the BOC in marketing its own CPE is available to competitors. The regulation is clear and no commenter has offered evidence that the

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[30] The effect of federal regulation on any alleged BOC ability to cross-subsidize is discussed more fully in Section IV, *supra*.

[31] FCC Comments, at p. 18.

BOCs have even attempted to avoid the duty imposed. Although the CPNI requirement is not applicable to equipment such as central office switches, there is no competitive advantage that a BOC can derive from the possession of CPNI in the markets for such equipment, since the purchase and installation of basic telecommunications network equipment generally does not involve transacting with specific customers.

C. The BOCs Have No Ability to Manipulate Their Networks to Favor Affiliated Manufacturers

Some commenters (AT&T, pp. 107-108; NATA, at 26 et seq.) voice concern that the BOCs, if allowed to manufacture, would have the ability and incentive to design their networks to provide unfair competitive advantages to their manufacturing affiliates. Such arguments ignore the very substantial regulatory, competitive and economic constraints on such behavior.

In markets for the local exchange's basic building block -- central office switches -- the size of the investment required for successful manufacture, distribution, marketing and service operations precludes any effort to match the characteristics of the equipment to a single local network. Dr. Huber observes that a competitor in the switch market, even an RHC, in order to survive would have to have a product attractive to a broader range of customers than merely its own BOCs. (Huber, p. 14.14) Therefore switch design must adhere to generally accepted standards.

Other market considerations limit the BOCs' incentive to manipulate network design to overspecialize in a narrow range of compatible equipment. Dr. Huber estimates that the BOCs earn revenue in the neighborhood of $4 billion per year from the provision of service to PBX customers. (Huber, p. 16.8) It is illogical speculation to assume that BOCs would endanger the significant revenue stream from network interconnection of a wide array of terminal gear to their networks by manipulating network design to disadvantage competitors.

It is no longer the case that any single entity determines national network standards. Since the dissolution of the Bell System, various standard-setting groups have attained considerable importance. Typically these groups include representatives of local exchange carriers, interexchange carriers, and equipment manufacturers. As stated by Dr. Huber and reiterated by several commenters, adherence to the standards determined by such groups is generally voluntary (Huber, p. 16.19); that does not mean, however, that the BOCs would choose to ignore such standards or that they could do so with impunity. A BOC that systematically refused to adopt standards in general use in an effort to exclude competitors would soon find itself the object of close scrutiny by competitors, the Justice Department, various state and federal[32] regulators, and perhaps this Court as well. No BOC would be willing to engage in such easily detectable, high-risk behavior, and even if one did, appropriate remedies would exist under antitrust law, regulatory law, and in certain circumstances, under the Decree itself.

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[32] See, e.g., In the Matter of Furnishing of Customer Premises Equipment by Bell Operating Telephone Companies and the Independent Telephone Companies, Report and Order, CC Docket No. 86-79, released January 12, 1987, ¶28.

Finally, the FCC has implemented requirements that the BOC fully disclose pertinent network data to competing CPE vendors. Under the FCC's recent order, a BOC is required "to notify the CPE industry that a new or modified network service is under development at the point it makes a decision to manufacture itself or to procure from an unaffiliated entity any product the design of which affects or relies on the network interface."[33] The notice must state that relevant technical and market information will be made available to any entity involved in manufacture, design, lease or sale of CPE. Additionally, at least twelve months prior to implementation of a new or modified network service, the BOC is required to disclose to the public technical network information and market data relevant to the service. Furthermore, if the BOC discovers new information concerning one of its operational services, it must disclose that information if it would have been subject to disclosure had the BOC been aware of it at the time it provided notice that the service was under development. These rules anticipate and prevent such perceived risks as BOC concealment of network information critical to the manufacture of compatible equipment, or discriminatory development or implementation of network standards. In short, the risks alleged by opposing commenters are speculative and unrealistic.

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[33] _Id_. at paras. 41 and 51.

D. The BOCs Should be No More Restricted in Foreign Affiliations Than Any Other Business

Concerns regarding the likelihood of BOC joint ventures with off-shore manufacturers are both speculative and irrelevant to the consideration of relief under Section VIII(C). There are numerous domestic telecommunications equipment manufacturers, and there is no reason to predict that the BOCs would discriminate against them in selecting appropriate affiliations. Moreover, the benefits of new research and development investment are independent of the nationality of the vendor. Telecommunications network performance, like the Decree itself, is not affected by nationality.

Neither AT&T nor the other manufacturers seem concerned about their own foreign affiliations and joint ventures. For example, in 1984 AT&T entered joint ventures in Holland, Japan, Korea and Italy for the production of switching equipment, key systems, lightwave systems, personal computers, software and satellite communications equipment. Additionally, in 1984-86 AT&T began to participate in the operation of offshore plants in Taiwan, Singapore, Thailand and Spain. These plants produce switching equipment, residential telephones, and microelectronics to name a few items. *See*, *e.g.*, *Asian Wall Street Journal*, July 11, 1983; "The Report on AT&T", *Communications Week*, May 6, 1985, at 10-11; *The Wall Street Journal*, July 8, 1985, at 4; *Communications Week*, April 28, 1986, at 51. It is difficult to take seriously any concerns regarding possible foreign affiliation by the BOCs in view of the substantial history of successful multinational ventures in this industry.

To deny the BOCs the right to affiliate with foreign manufacturers would deny them, but no other business, access at the important development stage to current technologies being explored by foreign manufacturers for provision to world markets. BellSouth is committed to provide the best technology for its network at the lowest cost. The BOCs' fundamental efforts to keep rates for regulated services as low as reasonably possible will benefit from participation in manufacturing. Those efforts will be frustrated if the BOCs are denied access to the best technology at the lowest price.[34] The nationality of the source for that technology is irrelevant.

E. The BOCs Will Not be in a Position to Foreclose the Manufacturing Market

The national and international scope of the telecommunications equipment markets precludes BOC domination of those markets.[35] These markets are characterized by rapid technical change, and have seen vast developments since the Decree was approved in 1982. Among hundreds of companies, both domestic

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[34] Forbidding the BOCs to affiliate with foreign producers will not forestall foreign competition in any event. Whether or not the BOCs are allowed to affiliate with foreign manufacturers, such producers will continue to sell products to the BOCs.

[35] For example, Dr. Huber observes that the central office switch market is probably international in scope (Huber, p. 14.2), as are the transmission equipment markets (Huber, p. 15.3) and markets for some terminal equipment (Huber, p. 17.3).

and foreign, these markets include such concerns as AT&T, GTE, and IBM/Rolm, some of which have very significant shares of domestic market segments.[36] There is no possibility that the BOCs will, if allowed to manufacture, dominate these markets especially when the presence of incumbent firms is acknowledged.

NATA argues that removing the prohibition would result in the BOCs supplying virtually all their equipment needs through their own affiliates, producing a "Balkanization" of the marketplace into seven regional "cartels" in which the BOCs would be predominant (NATA, at p. 17). There is no basis for this argument.

The risks involved in entering a highly competitive business requiring national and international market participation will deter some RHCs from entering. According to Dr. Huber, those RHCs that do enter are likely to manufacture few items, rather than attempt the investment requirement to produce the vast array of equipment required by the industry (Huber, at p. 14.13). It is obvious, therefore, that the BOCs will continue as customers for a large number of unaffiliated equipment manufacturers. Moreover, removal of the manufacturing restriction, in and of itself, will encourage existing suppliers to be more responsive to BOC-initiated technological changes.

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[36] For example, Dr. Huber estimates that AT&T, Northern Telecom, Inc., and GTE, currently have about 95% of the U.S. market in central office digital switch manufacturing (Huber, p. 14.5). In the area of transmission equipment, Dr. Huber notes that AT&T controls nearly half the sales in the U.S. (Huber, p. 15.4).

Assuming removal of the prohibition, BOC purchases of telecommunications equipment from affiliated manufacturers would be no more anticompetitive than such purchases by General Telephone from its manufacturing affiliate or AT&T from AT&T Technologies. To the extent that the affiliate provided quality equipment at competitive prices, such purchases would neither violate antitrust law nor undermine the accomplishments of the MFJ.[37]

F. The BOCs Should Not be Limited to AT&T as a Supplier

AT&T makes the most blatant plea of all the manufacturers for protection from competition by the BOCs or by any other manufacturer from which the BOCs might purchase equipment. As Dr. Huber pointed out, and as is generally known, AT&T is the only American manufacturer of several key telecommunications switches. AT&T is also the only manufacturer, American or foreign, in a position to modify the vast majority of the BOCs' networks because it made most of the equipment and controls access to the technical specifications needed for modification. Therefore, absent relief from the current prohibition on manufacturing (which AT&T interprets as absolute), the BOCs will continue to be captive customers of AT&T.

That is just what AT&T's comments ask. Starting from a litany of the Justice Department's original charges against AT&T

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[37] MCI makes a similar argument (pp. 73-74) concerning foreclosure of the BOCs as a market. The MFJ did not have as a purpose the protection of incumbent manufacturers from new competition, even if the new competitors are the BOCs.

and Western Electric, AT&T concludes that the manufacturing restriction was "the central antitrust purpose of the decree." (AT&T comments p. 83) It also suggests that the Court's objective in approving the Decree was to interfere with the relationships between AT&T, Western Electric and Bell Labs to "the minimum extent necessary." (AT&T comments, p. 98)

From these premises, AT&T argues that it would "undermine these purposes of the Decree" (AT&T comments, p. 99) to permit the BOCs to affiliate with manufacturers other than AT&T. AT&T's comments paint a bleak picture of the future of Bell Labs and the national telecommunications network should this happen. (AT&T comments, pp. 99-100, 106-108).

A number of inconsistent and illogical arguments are used to support AT&T's assertion that the central purpose of the Decree is to preserve the BOCs as captive customers for AT&T. AT&T, almost alone among the commenters, sees no change in the manufacturing markets since approval of the MFJ. This conclusion is based in part on AT&T's apparent view that the Court cannot recognize any change that was anticipated at the time the Decree was entered.[38]

AT&T also assumes that a key purpose of the Decree was to avoid future disputes. (AT&T comments, p. 91) This was not a basis for the Court's approval of the Decree. Rather, approval was based upon the view that entry of the MFJ was in the public interest. Changed circumstances since 1982 have rendered the manufacturing prohibition contrary to the public interest. It has inhibited service improvements and cost reductions, and the competitive concerns it addressed have been "attenuated to a shadow." "Potential disputes" should not be a basis for the Court's rejection of the Justice Department's Recommendation.

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[38] Throughout its comments, AT&T excoriates the Justice Department for having changed position from its original contentions in trying the case. The Justice Department, however, adheres faithfully to its original commitment to the Court to review the Section II(D) restrictions and to recommend their removal as warranted by technical, economic, or regulatory conditions. Any other understanding of the government's position would be inconsistent with this Court's decision to permit entry of the MFJ.

The message revealed by AT&T's transparent comments on the manufacturing restriction is an unfounded belief that the BOCs should remain captive customers of AT&T. The Justice Department and many of the commenters see what AT&T does not: that changes in the manufacturing market require removal of the restriction.

VI. INTERLATA RESTRICTIONS SHOULD BE REMOVED

The Justice Department has recognized, under the applicable Section VIII(C) standard, that extraregional interLATA service restrictions should be removed. The Department has also concluded that any interLATA restriction for mobile services should be removed. As a condition to BOC entry into intraregional interexchange services on an integrated basis, the government suggests that regulatory barriers to intraLATA competition be removed and that resale of BOC services be allowed. BellSouth's position set forth in its Comments is that certain segments of the intraregional interLATA market, when tested against VIII(C) standards, are ripe for BOC entry and that on an interim basis, the provision of such interLATA services through a structurally separated entity meets all Decree concerns. None of the positions advanced in the comments provides an adequate basis for any other conclusions.

A. BOC Provision of Extraregional InterLATA Services Raises No Genuine Possibility of Abuse

The Justice Department's recommendation on BOC provision of extraregional services started with an analysis of the significant change that has occurred in competition among interexchange carriers since the Decree was entered. The Department relied upon Dr. Huber's findings that competition in the provision of interLATA services to many large urban markets is vigorous. Huber Report, pp. 32-36. Therefore, in its Section VIII(C) analysis of extraregional services, the Department focused on whether there were any potential anticompetitive effects of BOC entry into the market. Because BOCs have neither "bottleneck" facilities nor the ability to cross-subsidize such extraterritorial activity, the Department concluded that a BOC would have no significant ability to impair competition outside the region. Recommendations at 76.

In response to the government's analysis, the commenters raised two unmeritorious arguments: (1) BOC entry may prove harmful to existing competitors, and (2) allowing BOCs to enter the market would result in the BOCs' diverting capital required to complete equal access implementation. The proper response to the first argument is found in the Recommendations. The Department recognized that BOC entry into the interexchange market might cause financial injury to particular competitors. However, the Department also articulated the appropriate legal principle that any potential harm to competitors as distinct from competition is not the concern of either the Decree or the antitrust laws. Recommendations at p. 67 and n. 136. At best, such arguments should be seen as attempts to protect the financial interests of the commenting parties. BOC entry would enhance competition, which is the fundamental goal of the antitrust laws and is embodied in the MFJ.

The "capital diversion" argument is unsupportable. BellSouth's stated policy, its historical performance and its ongoing implementation plans refute any suggestion that equal access is threatened by the Court's determinations under Section VIII(C). It is clear from the affidavits of Robert M. Wolfe, previously filed with the Court, that equal access implementation is the number one priority of the BellSouth operating companies. It is equally clear that by September 1, 1986, over 70 percent of its access lines were converted to equal access and that over 94 percent of the lines will be converted by the end of 1988. BellSouth Comments, at 29. Self-serving speculation is a poor substitute for BellSouth's proven performance in meeting and exceeding its equal access obligations.

The only other matter raised by the commenters on BOC provision of extraterritorial services that warrants discussion is the Justice Department recommendation that originating extraregional services not be allowed to terminate in an affiliated BOC's territory. Even AT&T, the interexchange carrier with the lion's share of the market, recognizes that the proposed limitation is unworkable since it would prevent the BOCs from meeting customer demands for service. AT&T correctly acknowledges that the market for interexchange service assumes national termination capability. AT&T comments at 72-73. However, AT&T fails to acknowledge that, under the Decree's standards, the appropriate solution is to eliminate the suggested intraregional termination restriction.

As BellSouth discussed in its Comments (pp. 44-46), the condition on intraregional terminations should be rejected by the Court. The most significant factual predicate supporting that position is found in Dr. Huber's Report and may be simply stated: for interLATA traffic, control at the originating end is a necessary condition for any alleged potential for BOC discrimination. Huber Report at p. 3.11. Outside its region, a BOC affiliated carrier would have no control over network facilities used for origination.

In its comments, the FCC also recognized the disfunctional nature of the proposed limitation on terminations within the region. The FCC noted that terminating ubiquity is a necessary part of an effective competitive interexchange alternative.[39] Therefore, to the extent that BOC entry into extraregional interLATA business provides a positive competitive alternative, there is no valid Decree basis to handicap BOC entry by imposing a disfunctional limitation.

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[39] FCC comments at 36. As an additional protective measure the FCC also suggested that any residual Decree risks would be abrogated by a further requirement that such termination be provided by reselling services of an unaffiliated carrier. Id.

B. InterLATA Restrictions on Mobile Services Should be Removed

The Department's recommendation to remove the restriction for both intraregional and extraregional interLATA mobile services is supported by technological and marketplace developments. The FCC has mandated that each Metropolitan Statistical Area ("MSA") have two cellular system operators. Therefore, the cellular business is competitive. BellSouth Mobility Inc ("BMI"), BellSouth's cellular mobile telephone subsidiary, competes in each of its markets with a "non-wireline" cellular carrier which, in all but one case, is not subject to the MFJ restrictions on provision of interLATA service.

As the Court has recognized (United States v. Western Electric Co., 578 F.Supp. 643, 650 (D.D.C. 1983)), there are two markets potentially affected by BOC provision of interLATA cellular service: interexchange services and cellular services. The Section VIII(C) standard is clearly met with respect to interexchange services. First, BMI has undertaken and completed implementation of equal access in all of its markets where equal access is technically feasible. It has committed to do so in the remainder of its markets as soon as the switch manufacturer can supply the required equal access capability. Second, even if BMI were allowed to compete for interLATA business, it would be competing against established carriers with existing assets, operations, and customers. Those carriers have quickly alerted the Court and other regulatory bodies to allegations of improper conduct. Finally, as the Court has previously recognized, cellular is not a substitute for wireline interLATA service. Indeed, cellular service appears to be complementary to interLATA services. The availability of cellular service tends to stimulate additional interLATA calling that would otherwise not occur.

Under the current restriction, the BOC cellular affiliate's inability to provide interLATA service puts it at a distinct competitive disadvantage against the "non-wireline" cellular carrier. In those areas where the FCC-mandated MSA happens to include territory in more than one LATA, a BOC affiliate incurs the expense and, more importantly, the delay of seeking a waiver from the Court to allow it to serve the MSA, while its competitor has no such entry burden. In addition, even when such waivers have been granted, the Court has required the BOC affiliate to obtain any necessary interLATA facilities from an interLATA carrier. Furthermore, post divestiture developments in cellular technology enable both wireline and non-wireline carriers to provide interLATA services. This combination of technological and regulatory factors creates inefficiencies and added expense that competitively disadvantage BOC cellular affiliates.

Finally, the argument raised by certain cellular "non-wirelines," such as Radiofone, that the interLATA restriction should not be lifted because of the interconnection policies of the BOCs, is without merit. There is no evidence that BMI's non-wireline competitors have received less favorable interconnection than BMI. The BOCs' affiliated cellular carriers are required by FCC regulation to receive interconnection that is no more favorable in any respect than the interconnections provided to "non-wireline" carriers. Furthermore, interconnection policies are subject to active regulation by the FCC and the state public service commissions. Any cellular carrier that suspects improper behavior can seek redress before those bodies. Moreover, such interconnection policies have no particular relationship to the interLATA restrictions.

In short, removal of the interLATA restriction would allow fair competition between BOC-affiliated cellular carriers and their non-wireline competitors. That competition will increase cellular networks' efficiencies and customer choice and convenience.

C. Intraregional InterLATA Restrictions Should be Removed

In its recommendations on BOC provision of intraregional interLATA service, the Justice Department recommended that BOC entry be conditioned upon meeting specified conditions related to intraLATA competition. BellSouth has proposed a structurally separated alternative as an interim measure to meet Decree concerns and to allow immediate BOC entry.

The comments filed by various parties both support and attack the Justice Department's recommendation. None of the comments addressed BellSouth's proposed interim solution since the filings were made contemporaneously. The greatest opposition arose from entities that currently provide interLATA services. A representative sampling of the self-serving arguments advanced by those parties includes assertions that: (a) the BOCs continue to have "bottleneck" facilities; (b) BOC entry would promote cross subsidy; (c) no significant technological changes have occurred that warrant BOC entry; (d) BOC entry would negatively effect universal service; and (e) BOC manipulation of access terms and conditions "proves" that they will unfairly compete for interLATA services. BellSouth's responses to the foregoing arguments are straightforward and satisfy all Section VIII(C) concerns.

In its recommendation to the Court, the government concluded that BOC provision of intraregional interLATA services, on an integrated basis with local exchange services, is not yet warranted. However, the Department recommended that the Court establish a set of conditions that when met, would allow BOC entry. The apparent intent of the conditions is to open intraLATA services to all competitors.

As an interim alternative, BellSouth proposed that the Court allow BOCs to provide intraregional interLATA services through a structurally separated entity. Section VIII(C) concerns would be addressed and satisfied by such a limitation. The separated BOC interexchange affiliated entity would have no "bottleneck" facilities. That separated entity would be required to obtain access on the same terms and conditions as any other carrier.

Attempts to cross-subsidize such a separated entity would be subject to scrutiny by federal and state regulatory bodies. Furthermore, current interLATA competitors have demonstrated a capacity for vigilant scrutiny and immediate action to redress perceived or suspected problems in dealing with BOCs. In practice, a structurally separated BOC interexchange provider eliminates "bottleneck" and cross-subsidy concerns.

BellSouth has also pointed out that any remaining Section VIII(C) concerns could be addressed by establishing an operating company group to deal with interexchange carrier access needs, including those of a BellSouth interexchange affiliate. A similar group has proven very effective in preventing discrimination in interconnection of various CPE competitors. See Huber Report at 337, n. 128. Therefore, the combination of a structurally separated entity and this additional safeguard will serve to eliminate all Section VIII(C) concerns.

Proper evaluation of these issues cannot ignore or minimize the enormous technological change and the impact of equal access implementation on interexchange markets. Although the BellSouth operating companies provide the majority of circuits through which their customers reach interexchange carriers, the local loop facility is carrier-neutral. Implementation of the customer's preference for interexchange service is accomplished in the equal access-capable central office switch. Whether or not BellSouth has an affiliated interLATA provider is irrelevant to the fact that the customer's preference can be implemented only through equal access technology. Of course, the switch at the terminating end of a call is always carrier-neutral.

At the time of divestiture, none of the BellSouth central offices was equipped to provide equal access. Therefore, the 1+ dialed interLATA carrier was AT&T. In the three years following divestiture, well over 70 percent of the access lines in BellSouth have been equipped for equal access and the customers with those lines have been given the opportunity to designate their preferred interexchange carrier. BellSouth's entry into the interexchange business on a structurally separated basis will do nothing to limit the equal access capability of the central office switches. A BellSouth affiliate would merely become another provider customers might select. Such competitive entry offers no possibility for BellSouth to use any alleged monopoly power to impede competition in the interLATA markets.

Assertions that BOC entry into the interexchange business will adversely effect universal service are unsupported. BOC entry may well reduce prices by intensifying for interLATA services. Allegations regarding manipulation of access tariffs are equally specious. As one example, under the heading "Denial of Access" MCI argues that BellSouth has failed to provide WATS access in compliance with FCC orders. When closely scrutinized, MCI's argument can most charitably be described as confused.

In a May 20, 1986 Order, the FCC concluded that jurisdictional limitations for WATS access line usage were unduly restrictive. However, in its subsequent order of May 30, 1986, in CC Docket No. 86-181, the FCC specifically provided that its earlier order did not purport to preempt state tariff restrictions on the use of such lines. May 30, 1986 Order, p. 7. In subsequent orders, the FCC reaffirmed that view and specified the manner in which an individual state's policy should be evidenced to the FCC. See, e.g., CC Docket No. 86-181, Order released January 6, 1987, pp. 1, 3. The BellSouth operating companies subsequently provided the specified information to the FCC from their respective state commissions.

For purposes of the Court's consideration in this proceeding, however, the relevant facts are as follows: (a) under state and interstate tariffs, WATS access has historically been provided via separate access lines for jurisdictionally intrastate and interstate use; and (b) as various state commissions expressed their respective intent regarding the continuing need for jurisdictional separation of WATS access lines in light of the FCC's order, BellSouth has conformed its tariff offerings. As a result, in six of BellSouth's nine states, WATS access lines remain jurisdictionally separated. In the remaining three, BellSouth operating companies offer bijurisdictional access lines. These actions are clearly not "a denial of access."

VII. THE PROHIBITION AGAINST BOC PARTICIPATION IN NON-TELECOMMUNICATIONS BUSINESSES SHOULD BE REMOVED

There is no substantial possibility that any BOC will be able to impede competition in non-telecommunications markets if Section

II(D)(3) of the Decree is removed. A major concern of the Court in approving restrictions on the post-divestiture BOCs was the possible anticompetitive use of the BOCs' local exchange facilities. In the case of non-telecommunications businesses, the BOC has absolutely no ability to either price or design its facilities and services to disadvantage competitors.

In addition, the BOC has minimal ability to cross-subsidize non-telecommunications businesses with regulated revenues. As a practical matter there are potentially only a limited number of joint and common costs between regulated telecommunications business and non-telecommunications businesses. The Justice Department recognized in its recommendation that anticompetitive cross-subsidization is a threat only when regulated and unregulated services share substantial joint or common costs. The recommendation takes into account the fact that joint and common costs in the non-telecommunications area will be limited to a few marketing and administrative functions. (Recommendations, p. 208) Thus, federal and state regulators will be able to concentrate their efforts and readily detect any attempts to improperly cross-subsidize non-telecommunications lines of business.

Further, actual experience since divestiture supports removal of the restriction. As noted by the Justice Department, though this Court has granted a substantial number of waivers for the BOCs to enter non-telecommunications businesses, there is no evidence that any BOC has raised impediments to competition in those businesses in which it participates.

Finally, the BOCs have also shown that they can and will maintain and develop their networks to provide their customers with high quality service and to provide new network services at as rapid a pace as technology will allow. This commitment to the customers of their regulated services has been proven even in the face of the tremendous effort required to make equal access a reality for the vast majority of end users.

While various RHCs have made substantial investments in unregulated, non-telecommunications businesses, there is no evidence before this Court that BOC customers have been deprived of exchange services they should have had, or that they have paid unreasonably high rates for regulated service due to these investments. In fact, the BOCs have every incentive to develop the regulated services which are and will continue to be their most important source of revenue. As the BOCs face increasing competition in network services, their strong incentives to keep the price of existing and newly developed services at reasonable levels will intensify. This is essential to encourage use of their services by a broad range of customers.

The original "quarantine" theory for including the Section II(D)(3) prohibition in the MFJ was repudiated by the Court in its approval of the MFJ.[40] Regulatory scrutiny will eliminate any potential for cross-subsidies. Experience since divestiture has shown that public interest considerations are not threatened by removal of the restriction. Therefore, the Court should accept the government's recommendation that the non-telecommunications prohibition be removed.

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[40] 552 F. Supp. at 187.

CONCLUSION

The comments filed by the parties and various intervenors to this proceeding provide considerable support for BellSouth's request. Some commenters argue that such relief is untimely, inappropriate or should be subject to onerous conditions. However, when the relevant facts are considered -- particularly the significant changes in technology, competition and regulatory oversight that have occurred since the Decree was entered -- and the Section VIII(C) standard applied, it is clear that antitrust objectives would be thwarted by continuing the current Decree restrictions.

WHEREFORE, BellSouth respectfully requests the Court to remove the Section II(D) restrictions in accordance with the foregoing Motion. An appropriate Order is attached.

Respectfully submitted,

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April 27, 1987

APPENDIX A

COMPARABLY EFFICIENT INTERCONNECTION (CEI) AND OPEN NETWORK ARCHITECTURE (ONA)

Each BOC must file its Open Network Architecture (ONA) plan by February 1, 1988, and must offer initial set of unbundled key Basic Service Elements (BSEs) within one year of approval of its plan. The plan must also specify the BOC's procedures for offering the full set of BSEs specified in its ONA plan and "the further development of ONA through the introduction of new BSEs and for meeting industry requests for BSEs."[1] To offer an enhanced service without structural separation prior to approval of its ONA plan, a BOC must meet the FCC's Comparably Efficient Interconnection (CEI) requirements.

(1) Comparably Efficient Interconnection

In general, the FCC requires that the basic service functions utilized by a BOC in the provision of an enhanced service must be made available to others in compliance with the following parameters:

1. BOCs must provide standardized hardware and software interfaces supporting transmission, switching, and signaling identical to BOC-provided enhanced service.

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[1] FCC News, Report No. DC-873 (March 26, 1987).

2. All basic services utilized by a BOC's enhanced services must be unbundled and have a CEI rate element.

3. BOC's enhanced services operations must take basic service functions at the unbundled, tariffed rates.

4. Transmission parameters and quality and reliability characteristics for others must be equal to what is provided to a BOC's own enhanced services.[2]

5. Time intervals for the installation, maintenance and repair of basic services in a CEI offering must be the same as for the BOC's enhanced services.

6. Capabilities such as abbreviated dialing or signaling and derived channels available to access or activate a BOC's enhanced services must be available enhanced services.

7. A BOC's CEI offering must be "fully operational and available on the date that it offers its corresponding enhanced services to the public."

8. BOCs must "minimize interconnection costs for other providers either by adopting a collocation policy or by providing the most efficient available means of concentrating traffic, such as loop or trunk multiplexing . . . ."[3]

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[2] The FCC's standard for ONA and CEI is "full technical equality," which will include consideration of "equality as perceived by end users." FCC News, Report No. DC-873 (March 26, 1987).

[3] Computer III Order at ¶147.

9. CEI availability from interstate tariffs cannot be restricted to any class of customer or competitor.[4]

For CEI pricing, the FCC utilizes both a cost-based approach and an averaging approach as required to accomplish its dual goals of allowing BOCs to take advantage of the true efficiencies of collocation or integration and of increasing the interconnection efficiencies available to BOCs' competitors.[5] BOCs will be allowed to price transmission to reflect distance-sensitive costs "in order to promote the availability to the public of low-cost, efficient enhanced services."[6] Prices for interconnection and basic traffic concentration, however, must be developed by averaging costs to give the BOCs the incentive to design and install the most economical interconnection and concentration facilities for their competitors.

The basic pricing safeguard is, of course, the requirement that the same tariffs apply to both BOCs' enhanced services and their competitors. Sample state and federal tariffs must be included in BOCs' CEI plans.[7]

The FCC requires that the CEI plans describe the procedures that the BOCs will use to "ensure the nondiscriminatory provision of basic services, including the installation, maintenance and quality of such services, to competitive enhanced services providers and their customers."[8] The BOCs will be required to file quarterly CEI reports that must include "data on the timing of installation and maintenance and the quality and reliability of the basic services offered as part of any CEI tariff . . . ."[9] The FCC has used this method successfully for several years to monitor compliance with its equal interconnection rules for customer premises equipment.

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[4] Computer III Order at ¶¶154-166.

[5] Computer III Order at ¶¶171-186.

[6] Computer III Order at ¶175.

[7] Computer III Order at ¶190.

(2) Open Network Architecture

Implementation of ONA will enable BOCs to offer enhanced services without filing a CEI plan for each new service. The ONA requirements build on the CEI requirements by extending the service-specific goals of CEI into the design of the entire network. Following is a summary of the ONA standards that the FCC has established:

1. Each BOC must develop and offer a list of Basic Service Elements (BSEs) on an unbundled, tariffed basis to competitors on the same terms and conditions as to its own enhanced services. The initial set of BSEs must be developed with the participation of the industry and must be made available within one year of approval of the ONA plan.

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[8] FCC News, Report No. DC-872 (March 26, 1987).

[9] Id.

2. The ONA plan must incorporate a technical design that satisfies the CEI parameters described above.

3. The network designs that satisfy the ONA requirements will be developed with the participation of private standards organizations. Contrary to the assumption of some commenters, the BellSouth companies fully expect to deploy ONA in both analog and digital stored-program-controlled (SPC) switches, and they plan for all of their switches to be SPC by the end of 1990.

4. BOCs must file ONA plans describing compliance with the above requirements and listing an initial set of BSEs by February 1, 1988. Approval of a BOC's plan is a precondition to full structural separation relief. Amendments to approved ONA plans must be filed 90 days prior to offering an enhanced service using a new BSE. Public comment and approval by the Common Carrier Bureau are required prior to implementation of an enhanced service using the new BSE.

APPENDIX "B"

IN THE

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff v. WESTERN ELECTRIC COMPANY, INC., et. al., Defendants	Civil Action No. 82-0192

AFFIDAVIT OF

Dr. Jagdish N. Sheth

Robert E. Brooker Distinguished Professor of Marketing & Research

University of Southern California

COUNTY OF LOS ANGELES)
) S.S.
STATE OF CALIFORNIA)

Jagdish N. Sheth, being duly sworn, deposes and says:

1.

This affidavit is submitted in support of the Justice Department's recommendations that restrictions related to information services imposed on the Regional Holding Companies (RHCs) be removed, as well as in support of Bell South Corporation's Motion for Relief from Section II (D) of the Modification of Final Judgment.

Background

2.

I am the Robert E. Brooker Distinguished Professor of Marketing & Research in the Graduate School of Business at the University of Southern California (USC) in Los Angeles. I am also the Founder and

Director of the Center for Telecommunications Management at USC, which conducts research and education on the emerging strategic issues in the telecommunications industry with a special focus on markets, customers, competitive structures, competitive strategies and globalization of the telecommunications industry.

Prior to joining the faculty at USC, I was the Walter H. Stellner Distinguished Professor of Marketing at the University of Illinois (UI)-Urbana-Champaign and was on the faculty of UI for fifteen years since 1969. Prior to that, I was on the faculty of Columbia University and Massachusetts Institute of Technology (MIT) for a total of six years.

3.

I received my Bachelor of Commerce (Honors) Degree from Loyola College, University of Madras, India in 1960. I received my MBA and Ph.D. from the University of Pittsburgh in 1962 and 1966 respectively.

4.

I am a Fellow of the American Psychological Association. I am past President of the Consumer Psychology Division of the American Psychological Association as well as Past President of the Association for Consumer Research (ACR). I am on the Editorial Boards of numerous scholarly journals in the field of marketing, management, international business, psychology and quantitative sciences. I have published more than 150 scholarly papers and several books in the areas of international business, marketing, competitive strategies, customer understanding and applied multivariate statistics. A full resume reflecting my academic background is attached to this Affidavit as Attachment "A".

5.

I have provided both consulting and executive education services to numerous corporations and governmental agencies, both in the U.S.A. and in foreign countries over the past 20 years of my career. These include General Motors, Monsanto, Petrolite, 3M, ALCOA, Pillsbury, Whirlpool, General Dynamics, IBM, General Foods and General Electric.

The primary focus of consulting and/or executive education has been understanding customers, market segmentation, competitive strategies, globalization of industry, and emerging market trends.

6.

For the past 18 years, I have been a consultant and an executive educator in the telecommunications industry. My fields of expertise have been marketing, competitive strategy, market research, international business and futures research. I have consulted and/or provided executive education to several corporations, including Northern Telecom, Rockwell International, Fujitsu, B.C. Telephone, Bell Canada, Telecom Canada, Singapore Telecoms, Hong Kong Telephone Company, GTE, AT&T, the Bell Laboratories, and the now divested Bell Operating Companies (BOCs).

Focus

7.

The focus of this Affidavit is limited to information service. Information service, as defined by the Modification of Final Judgment (MFJ) or the decree 1/*, is "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information which may be conveyed via telecommunications." By definition, information services require integration of computers and communications.

This definition covers a wide variety of services that involve the interaction of information processing and transmission facilities. Both the Huber Report 2/ and the Justice Department's Recommendations 3/ have attempted to classify information services into three categories as follows:

> "Information services thus include, at one extreme, low-level code and protocol conversion services, which merely provide electronic translation to facilitate communication between electronic devices by packetizing and reconfiguring data. At the other extreme, they include high-level information access and retrieval services that provide on-line reference to data stored in electronic data bases, law libraries, government documents, and a range of other information services. Information services between these extremes include public announcement, voice

* This and all subsequent citations are found in "A" of the Affadavit.

storage and retrieval, electronic mail, credit card transactions, and remote alarm monitoring and meter reading services." 4/

8.

Although the arguments presented in this Affidavit are equally appropriate for all types of information services as defined above, this Affidavit is prepared with a specific focus toward those information services which meet the following criteria:

a. Information services which primarily utilize the class five central office switches.

b. Information services which possess the characteristics of mass market in which there are a large number of users and suppliers. Therefore, they are comparable to other mass media information services such as newspapers, magazines, television, cable and radio.

c. The primary users of these information services are the residential and the small business customers.

d. These information services integrate storing, processing, transforming and retrieving of information via telecommunications. In other words, they are referred to as enhanced services above and beyond the basic services.

Conclusions

9.

This Affidavit supports the Justice Department's Recommendations and Bell South's Motion that the restrictions related to information services should be removed.

First, information services, especially for the mass markets, are very slowly evolving. Both the economy of scale and scope suggest that the market needs a catalyst that can organize the industry into an information mall similar to organization of the shopping malls by retailers. Furthermore, the most logical and cost effective way to create a market catalyst is the central offices of the local exchange carriers, including the BOCs. This is clearly demonstrated in many foreign countries, especially in France, where the DGT has successfully acted as a market catalyst.

Second, RHCs are the biggest buyers of telecommunications equipment. By not allowing them to offer the information services, the nation's telecommunications network will become obsolete. This will have immediate and direct negative consequences on the U.S. telecommunications industry's ability to compete in the international markets. It will also have the indirect effect on U.S. competitiveness in a global economy by depriving the nation of productivity and growth benefits from information services.

Rationale

10.

There are three major reasons why it is not only desirable but imperative that the information services restrictions imposed on the RHCs be removed as soon as possible.

1. The public interest will not be served by maintaining the current restrictions. The tremendous potential of improving the nation's productivity through information services will be limited to only narrowly defined specialty markets unless the BOCs offer the information services. This is because the process of competitive market evolution is not capable of developing the mass market for information services. Market evolution of information services has been very slow to date. It needs a market catalyst. The BOCs are the best catalysts for information services, especially for the mass market information services. Indeed, experience in several foreign countries demonstrates that it is only with the participation of the local telephone companies that mass market demand for information services has emerged.
2. The U.S. as a nation will lose its international competitiveness in the telecommunications industry if its biggest providers of service are barred from modernizing their technology through integration of communications and computers.
   Similar regulatory restrictions in other industries have created a permanent competitive disadvantage vis-a-vis foreign countries, resulting in not only the demise of the

industry, but also its suppliers. In short, if the BOCs are not allowed to offer information services, it will make local exchange facilities obsolete, resulting in lack of demand for more advanced switches and other telecommunications technologies from the domestic manufacturers.

3. RHCs potential for unfair competitive advantage due to bottleneck facilities seems more apparent than real. There is significant competition from cross-elastic substitute technologies as well as enough regulatory safeguards put in place to alleviate this concern.

Information Services Needs a Catalyst

11.

A number of factors indicate that without the active participation by the BOCs, the market for information services will be limited to highly specialized and narrowly defined vertical markets despite the obvious mass market opportunities created by the needs of the emerging post-industrial society. This is due to the fact that information services possess market characteristics that will require a market catalyst to create the opportunity for making competitive information services widely available.

The information services market is very similar to a shopping mall in its market characteristics. 5/ First, the fixed cost of the infrastructure facilities necessary to create a shopping mall is so expensive that it is virtually impossible for any one retailer to build, operate and merchandise the total shopping mall. For example, parking, security, credit card and other support services dictate that there will be strong economies of scale in sharing these facilities.

Second, the shopping mall customers are looking for the convenience of one-stop shop to economize their shopping time and effort. In other words, consumers come to a shopping mall to shop for a very diverse set of needs and wants. They want to buy both products and services; both functional as well as fashionable products; and both durable products (such as furniture and appliances) and consumables (such as drugs and toiletries). This requires a sharing of the common infrastructures among competing retailers to create the one-stop shop.

Third, most retailers tend to be either product or market specialists. In other words, each retailer is good at satisfying one or a limited set of consumer needs, but not all of them. This is certainly true of such specialty retailers as Foot Locker or The Limited. Surprisingly, it is equally true of the full line retailers like Sears and J.C. Penney. For example, Sears caters to primarily the middle class and mid-price point market and recently J.C. Penney has decided to focus on soft goods (clothes, furniture, furnishings) and get out of such hard goods as appliances and automotive parts.

In short, even though the customers want to satisfy all their needs in a one-stop shop, any one retailer is incapable of satisfying their needs unless they share common infrastructure facilities.

Finally, customers who shop in a shopping mall are highly diverse, each looking for products and services that are unique to their needs and wants. Each customer's bundle of needs and wants is so specialized that it results in a fragmented market. Therefore, economy of scope is achieved by sharing a common infrastructure that is capable of satisfying specialized or fragmented needs of the total market.

In my analysis, the information services market possesses all the characteristics of a retail shopping mall. The infrastructure resources of local loop, billing services, and account management are too expensive for any one information service provider to duplicate rather than share with others. Second, consumers are looking for one-stop shop convenience associated with the use of the same terminals, account management, billing and network maintenance. Third, at the same time, consumers are looking for different types of information which no single vendor is capable of satisfying, including the BOCs. Finally, the high degree of specialization inherent in information content requires that competing vendors share common facilities and infrastructure resources to make them more affordable to the mass market.

In other words, what is necessary for the information services to emerge as a viable market is an information mall or information bazaar where a large number of information users with very diverse needs and a large number of information providers with very diverse expertise share common infrastructure resources to carry out market transactions. It is the most efficient and effective way to create both economy of scale and economy of scope for information services, especially for the mass markets. In a retail shopping mall, the only way to create a successful retail market is to ensure that both large full service retailers such as Sears and J.C. Penney co-market with hundreds of specialty retailers such as Foot Locker and The Limited. Neither one can create the market without the presence of the other. They need each other. 6/ A similar parallel exists for the information services. In short, the most logical and economic way to offer information services, especially to the mass market, is to integrate them in the central office facilities of the local exchange companies.

A review of the failures and successes of different information services clearly demonstrates the above analysis. Despite more than one decade of marketing efforts, a mass market for voice messages, electronic mail, videotex, teletext, electronic banking, and teleconferencing services has yet to emerge. 7/ Furthermore, millions of dollars have been spent by such large organizations as Knight-Ridder, CBS, Sears, and AT&T to develop the information services market.

On the other hand, many public announcement services, custom calling services, and 911 emergency services have become popular mass markets because of the active participation by the BOCs. 8/

Similarly, it is the active participation of the local telephone companies in virtually all foreign countries that has created any success for the emerging information services such as electronic banking, shopping and education. In each case, the intelligence is housed and integrated in the central office of the local telephone company and not in the PBX. This is true in France, Germany, Canada, United Kingdom, Singapore, Hong Kong and Japan. 9/

Perhaps the best support for the successful development of an information mall with the active participation of the local telephone company comes from France. 10/ Half of the calls to Teletel, France's five year old videotex system, are to DGT's electronic telephone directory, but about 30 percent of the calls are to the information services provided by newspapers, magazines and a large number of entrepreneurs. A further 20 percent of the calls are generated by companies that use the system mainly for business. Customers can dial everything from gourmet meals to psychiatrists who let patients take psychological tests over the system. But the most popular and profitable information services are those that allow people to interact electronically. In addition to a lot of small entrepreneurs who could not otherwise enter the information services market, a number of large newspapers such a Le Parisien and Funitel are also actively participating in developing the information services for the mass market. For example, Funitel combines electronic chatting with computerized games. It is estimated that Funitel's service, which was launched in 1985, has returned its investment in less than one year. Similar successes are reported from more than a hundred information service providers. It is estimated that the Minitel today offers more than 2,000 information services through a one-stop shop information mall. 11/

The benefits of mass market information services is also reaped by the business customers. For example, Cetelem, France's biggest consumer finance company, now processes credit applications electronically from the retail stores to their computers, and 85 percent of all credit applications are processed in less than three minutes.

The fundamentals of success for the French experiment clearly are due to the development of an information mall through a shared infrastructure. It has resulted in both economy of scale and economy of scope. Furthermore, it has generated a convenient hasslefree procurement and use of information services for transaction, information, education and entertainment.

The Teletel system represents a perfect example of the development of an information mall through the active participation of the DGT as a market catalyst. First, it represents all aspects of information flow, including receiving or retrieving information (news, government procedures, legal rights, product catalogs, scientific data bases); sending information or executing a transaction (ordering products, paying bills, responding to a survey); and continuously exchanging information (games, education, teleconferencing).

Second, it brings together hundreds of information service providers, including banking, social welfare, health, travel and tourism, sports and job training. Finally, the Teletel system provides better economy of scale and scope than other videotex systems in the world. In fact, the French experience seems to demonstrate that it is much better for both the information users and the information providers to share one common infrastructure facility, rather than each vendor developing and marketing his own separate system as has been true in the U.S. 12/

The successful French experience in creating the mass market for information services is duplicated in several other countries, including Singapore, Canada, and the United Kingdom.

Loss of International Competitiveness

12.

Information services, by definition, require integration of computers and communications technologies. The technology evolution is clearly moving in the direction of this integration because of the inherent economies of scale and scope associated between computers (information processing and storage) and communications (information switching and transmissions). 13/

Furthermore, most experts in the world agree that integrated information services are as vital to national interests in the future as were the infrastructure technologies of railways and highways in the earlier decades. This is especially true of mature nations which are shifting from the industrial to the post-industrial society. 14/ Indeed, information technologies (computers and communications) are considered so vital to the national survival and growth by major U.S. competitors such as Japan, Germany, France and England, that they are regarded as a national strategic resource comparable to strategic raw materials in the agricultural and industrial eras. 15/

For example, Japan's Ministry of International Trade and Industries (MITI) has targeted information technologies for the future survival and growth of Japan similar to its past successful targeting of steel, shipbuilding, automobiles and consumer electronics. It has allocated hundreds of millions of dollars of public funds for research, development and commercialization of information technologies under the broad categories of fifth generation computers, INS network and semiconductors. 16/

And Japan is not alone in this commitment. Recently, the European Commission, as the administrative arm of the 12-nation European community's governing council, has proposed a five year, $800 million program to modernize the Pan European network by creating an integrated broadband network by 1995. The project is called Research in Advanced Communications for Europe, or RACE. 17/ The objective of the RACE program is to develop the techniques, technologies and components for an integrated broadband network throughout Europe, and it includes the development of switching methods, new types of software and integrated circuits. The basic objective in this initiative seems to be to give Europeans a competitive edge in the world market.

Finally, this integration of computers and communications is considered so vital that, under the leadership of CCITT, the International Telecommunications Union (ITU) of the United Nations has been working since the sixties to develop the ISDN standards that will ensure this integration. 18/ Indeed, the regulatory inability of the Bell System due to the 1956 Consent Decree seems to have resulted in Europeans taking the lead to set the next generation of telecommunications technology standards such as the ISDN. The United States industry is now forced to accept these standards and develop a crash program on a reactive basis to develop, design and install the new generation of ISDN switches both in the central office and in the PBX environments.

If the information service prohibition continues, the U.S. telecommunications industry, especially the central office switching and transmission area, is likely to suffer. This is because the RHCs are the largest customers of telecommunications equipment. The current restriction will limit the necessary modernization of facilities and create technological obsolescence in the central office switching and transmission technologies.

This technology obsolescence is clearly identified as the root cause of the decline of numerous other U.S. industries. 19/ Since the early seventies, a large number of scholars and practitioners have tried to analyze why the U.S. economy has lost its competitiveness, not only to such other advanced countries as Japan, Germany, and France, but to many developing countries such as South Korea, Brazil, Taiwan, Spain, Italy and even India.

The most common finding across all countries has been that technology modernization is the key to competitive advantage. Countries that have been unable to modernize their industrial base have suffered in the long run. On the other hand, countries and industries that have modernized their plants and facilities have often emerged as victors in global competition, even if they were distant poor competitors.

For example, Japan modernized its shipbuilding industry in the late fifties. It shifted from riveting to welding technology and became a world class competitor, destroying many entrenched, established countries, including Great Britain and Sweden. Similarly, Japan also modernized its machine tool industry by shifting the technology to numerical controls. Finally, it also modernized its consumer electronics industry by shifting from vacuum tubes to solid state technology, which resulted in a competitive disadvantage for both the European and the American manufacturers. At the same time, Japan has also suffered in those industries where it has not modernized its technology. This includes retail trade, restaurants, commercial aviation, and postal service.

An historical analysis of the United Kingdom's industries also reveals much the same. The decline of its traditionally dominant industries such as coal mining, shipbuilding, machine tools, and financial services suggests that the fundamental cause for the decline has been lack of modernization.

Historically, this has been also true in the U.S. Industries that have kept up modernization have remained strong despite world competition. These include commercial aviation, defense, processed foods, beverages, agriculture and more recently, household appliances. U.S. industries that lost to world competition due to lack of modernization include textiles, automobiles, consumer electronics, passenger tires, steel, agricultural machinery, trucks and construction equipment.

In my analysis, there is a similar danger in the telecommunications industry. The integration of computers and communication is the next logical progression for increasing performance-price ratio through economy of scale and scope. Indeed, it is integrated more and more on a planned proactive basis in most foreign countries, big and small, advanced and developing. This includes Japan, virtually every European country as well as many third world countries such as Singapore, Korea and Hong Kong. 20/ Even north of the border, in Canada, there is a significant integration of computers and communications. For example, Bell Canada, Telecom Canada, and B.C. Telephone, as well as some of the Crown Corporations offer a host of integrated information services at present which are prohibited to the BOCs in the U.S. 21/

Technology modernization inherent in integration of computers and communications is considered so significant that several countries are changing the structure of their telecommunications industry.

For example, British Telecom was privatized to encourage innovation and modernization. 22/ Even in a country that believes in and has a successful record of public ownership and management in many industries, India has decided to privatize the local exchange business in order to modernize its technology base. 23/

It is worth noting that this migration of the telephone business to the information age is likely to generate significant benefits to the domestic manufacturing sector. In Japan, both the network architecture and the central office switch have improved significantly because of the modernization of NTT. Similarly, Northern Telecom has greatly benefited from technology modernization in Canada. Finally, many European manufacturers are several years ahead in this evolution, including Ericsson, Thompson and Plessey. 24/

On the other hand, the domestic U.S. manufacturers have suffered significantly. We should all remember that both the local and national regulation of telecommunications discouraged innovation and modernization of the telephone terminals, especially for the single line mass market customers. The basic black telephone was the symbol of the telephone industry for many decades, similar to the black Model T by Henry Ford in the automobile industry.

The modernization and technology upgrade of the terminal markets began only when the Customer Premises Equipment (CPE) market was deregulated. In a very short period of time, manufacturers began to offer telephone sets with features and functions unheard of prior to deregulation.

A similar story emerged in the PBX market. Until the deregulation, PBX evolution was slow. The Bell System had stayed with the electromechanical PBX until competition was allowed by the regulators. This led to the development of the digital PBX switch by such U.S. manufacturers as Rolm.

In both instances, it is obvious that the regulatory restrictions were lifted more on a reactive basis rather than proactive basis. Unfortunately, it provided a strategic headstart to several foreign competitors in both the PBX and the terminal markets. Today, the market is heavily dominated by foreign suppliers, especially in the terminals market. And only recently has AT&T Technologies begun to regain significant loss of the PBX market by developing more modern digital switching such as System 75 and 85.

A similar pattern is very likely to emerge in the central office switch market unless the RHCs, the largest customers of central office equipment, are allowed to offer information services that will in turn encourage them to modernize the plant capacity.

RHCs Potential for Dominance Seems More Apparent Than Real

13.

The fear that RHCs will gain unfair competitive advantages because of their bottleneck facilities seems more apparent than real. It is based upon a lack of comprehensive understanding of the competitive forces that are present in any industry. It seems that there are significant market and competitive forces in place to minimize any competitive advantages the RHCs might possess because of their local loop and other bottleneck facilities.

Competition is not limited to the direct competitors in the market place who are rivaling to gain market share for the same product or service from one another. In addition to the immediate and direct competitors, a company also experiences or has the potential for competition from four other sources: (1) company's customers who are likely to bypass (backward integration) and create competition against the dominant supplier, especially if it has monopoly over market; (2) company's suppliers who are also likely to bypass (forward integration) in order not to depend on the dominant buyer, especially if it has a monopoly on buying; (3) new entrants who find the industry very attractive because the profits or returns on investments are lucrative, especially if the dominant vendor in the industry has monopoly power; and (4) substitute technologies, which are developed to create better performance/price ratio so that there is significant cross-elasticity.

Rivalry Among Existing Vendors. A number of existing information service providers possess significant competitive advantages over the RHCs, especially as they relate to information content and headstart. For example, a large number of powerful companies directly have databases that are virtually impossible for the RHCs to develop except through acquisitions or strategic alliances with them. These include airline travel reservation databases controlled by United Airlines (Apollo) and American Airlines (Sabre); Mead Johnson's control over the LEXIS and NEXIS databases related to professional services; Dow-Jones control over the financial and business information; and the publishing industry's control over the electronic databases related to information including encyclopedia, books, magazines and other libraries of information. 25/ These databases provide significant advantages to existing vendors over the RHCs by creating both cost and entry barriers. Since the biggest cost in information services is information content rather than information conduit, it is virtually impossible for the RHCs to gain competitive advantage over companies which have established databases. Furthermore, since information gathering and database creation is labor intensive and an expensive process, it is virtually impossible for the RHCs to duplicate those databases without significant cost increases.

Similarly, most existing information providers have a significant headstart over the RHCs in those markets where they have been successful. For example, it is virtually impossible for the travel agents to switch from the Apollo and Sabre systems to what the RHCs can develop as a competitive reservation system because there is a significant investment in technology, manpower training, and the potential risk of disrupting travel agent operations by switching over to competition. In fact, it has been difficult, if not impossible, for the Apollo customers to switch to Sabre system and vice-versa. A similar headstart advantage accrues to other information service providers such as CompuServe, Dow-Jones and Mead Corporation.

Competition from New Entrants. Not only do the existing vendors have strong cost and headstart competitive advantages, the information services market also possesses the threat of several new entrants. Since information services are both high growth and high margin businesses, it is attracting a lot of attention by many companies, both large and small. 26/ A few examples will suffice to demonstrate that the threat of new entrants will minimize or negate any competitive advantages possessed by the RHCs because of bottleneck facilities.

First, there are a significant number of independent local exchange companies such as GTE, Centel, United Telephone and Contel with comparable bottleneck facilities. Some of them such as GTE have already successfully entered the value-added network services (VANS) market.

Second, AT&T, the dominant interexchange carrier, possesses a number of capabilities including a national network, national sales and service organization as well as development of billing and related support services to enter the information services market. Indeed, AT&T, by experimenting with a number of information services, seems to express an interest in this emerging market. Also, other interexchange carriers such as MCI and U S Sprint are likely to follow AT&T as they successfully compete in the interexchange market.

Finally, a number of foreign telecommunications companies are entering the U.S. information services market. For example, Bell Canada has announced that it has started to franchise telephone answering services throughout the U.S. 27/

Customers Becoming Competitors. The large business and government customers are emerging as competitors in at least three ways.

First, a number of customers are investing in private networks built around the new generation of PBX's, which have significant capabilities for providing integrated information services. As they bypass the local networks for their basic telecommunications needs, they are also installing the capacity for bypassing the local networks for computerized information services. In other words, these large business and government customers are less likely to patronize information services integrated in the central office, especially if they believe that RHCs possess monopoly power over basic services.

Second, many large corporate customers, as they continue to invest in building private networks, begin to integrate their suppliers and customers telecommunications networks whether they are based on switched or dedicated services. This upstream and downstream expansion of other private network across many industries, including financial services, retailing and manufacturing, is likely to further create competition for the RHCs and other information services providers.

Finally, a small number of corporate customers are also beginning to offer their capabilities in information services to customers in the marketplace in direct competition with the existing information services providers. Examples include Westinghouse's investment in Electronic Office Centers of America and Fairchild's joint venture with the French company, Alcantel-Thompson.

Ultimately, it is logical to expect that all Shared Tenant Services (STS) with their smart switches will move from offering basic telecommunications to offering information services to all the small business and even residential customers concentrated in a geographical area.

Suppliers as Competitors. The potential competition from suppliers is usually present from two types of suppliers. The information content suppliers such as publishers and libraries are already converting their databases in the electronic form and offering them to customers as information services.

The equipment manufacturers such a Rolm, Northern Telecom and AT&T Technologies have aggressively downstreamed central office capabilities for information services into the PBX as well as the key systems. And this trend is likely to continue as office equipment manufacturers design and market smart terminals, including the personal computer.

In short, both the information content suppliers and information equipment suppliers possess technical expertise and market presence to offer information services directly to end users and thereby bypass the local telephone companies.

Substitute Technologies. Perhaps the biggest competitive force for RHCs in the information services market are the substitute technologies. On the one hand, there are numerous existing substitutes among the mass media to provide information services with comparable or superior economies of scale and scope. These include the traditional mass media, consisting of newspapers, magazines, radio and television, as well as the public libraries. The unique competitive advantage of these traditional, well established substitutes is that most of them are either totally free or highly subsidized by advertising revenues.

More recently, the cable television has also begun to emerge as a major, substitute technology especially in the metropolitan areas where two-way interactive technologies are being installed by the cable television industry. A number of information services, especially as they relate to entertainment and education, are currently provided through cable television.

Similarly, since the FCC's authorization to permit subchanneling of the FM bandwidth, a number of closed group information services such as financial and agricultural information services have emerged in the market place.

Although all of these substitute technologies are primarily suited for one way, one-to-many configurations, it should be remembered that most electronic information services, especially the nontransaction services for the mass market, require similar characteristics and configurations. These include voice messaging, electronic mail, public announcements and answering services.

In summary, a competitive analysis of the information services market suggests that the market forces will create far stronger competition for the RHCs than what might otherwise be presumed on the traditional economic concepts of bottleneck facilities and natural monopoly.

In addition to the market forces, the FCC has also put in place regulatory safeguards to prevent abuse of the monopoly powers of RHCs.

These include both technical network safeguards to provide equal access as well as accounting safeguards to minimize cross-subsidies from the tariffed to the non-tariffed services.

The dual forces of regulatory safeguards and market safeguards are sufficient to suggest that the RHCs potential to gain unfair competitive advantage in the information services is more apparent than real.

Summary

14.

In this Affidavit, I have analyzed the market characteristics of information services, especially those for the mass market. The analysis points to the following conclusions:

1. Without the active participation of the local exchange carriers, including the BOCs, it is unlikely that mass market information services will become popular. Information services are similar to retail shopping malls and need a market catalyst that will provide the necessary infrastructure which will be shared by a large number of information service providers.
2. Information services are vital to the future competitiveness of the U.S. economy in general and the telecommunications equipment industry in particular. They provide both growth and productivity for the U.S. economy. Since the RHCs are the largest buyers of the central office telecommunications products, they will be unable to upgrade their installed base unless they are allowed to offer information services. This, in turn, will discourage innovation among the U.S. suppliers, which will result in loss of competitiveness in the world market.
3. There are enough competitive and regulatory checks and balances to minimize any unfair competitive advantages for the RHCs. For example, existing information service providers have a strong headstart and control of information

content advantages. Also, several large companies are seriously interested in entering the information services market, including AT&T. Finally, the mass media, including newspapers, radio, television and cable providers have significant price advantages over electronic information services because of the cross-subsidy from the advertising revenues.

Jagdish N. Sheth

Jagdish N. Sheth
Robert E. Brooker Distinguished
Professor of Marketing and Research
University of Southern California

Sworn to and subscribed before me this 24 day of April, 1987.

ELLEN FOON
My Commission Exp. June 24, 1988

Ellen Foon

Notary Public

My commission expires:
6-24-88

Attachment "A"

FOOTNOTES

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Senator METZENBAUM. I see one of my distinguished colleagues has joined us.

Senator Heflin, do you have any opening statement?

Senator HEFLIN. No.

Senator METZENBAUM. Happy to have you with us, sir.

Senator HEFLIN. I am listening.

Senator METZENBAUM. I think that I am going to listen to each of the witnesses separately and then go to questions with respect to the entire panel, although I know some of you are coming from different positions, much different than others.

Mr. Zeglis, happy to hear from you, sir.

Mr. ZEGLIS. Thank you, Mr. Chairman.

My name is John Zeglis. I am AT&T's General Counsel, I am pleased to be here.

Mr. Chairman, it falls to me to explain why we came to have this decree in the first place, I believe this all ultimately reduces to a single controlling fact and two antitrust principles.

The controlling fact is that the Bell System's local exchange telephone operations were monopolies. Therefore, they were bottlenecks: bottlenecks to long distance competitors, who needed those telephone lines to reach their customers; and bottlenecks to manufacturers who wanted to sell equipment for the local monopoly networks.

The bottlenecks then gave us the first of the two antitrust principles. The first principle is that owners of central, non-reproducible facilities have special duties to let their competitors use those facilities.

The second all important antitrust principle is one that the Bell System fought and lost every time, that is, telephone companies are not immune from the antitrust laws simply because they are regulated by the FCC and the State Utility Commissions. Now, those conditions, ownership of the bottleneck monopolies, and exposure to the Sherman Act, combined in the 1970s to embroil us in a decade or more of all consuming antitrust litigation.

By the early 1980s, this kind of litigation had us in a gridlock situation. Way too much of our efforts focused on courthouses and not enough on competitive marketplaces. The only way out of that kind of morass was to give the Government's Antitrust Division exactly what it had been seeking in lawsuits against AT&T, divestiture of the monopoly local exchanges and an injunction that would prevent the divested companies from moving back into the competitive long distance and manufacturing businesses.

As a matter of fact, those two inseparably related conditions were the single non-negotiable demand that the Government made when it presented the decree to the Bell System. And there is logic in that, for if the problem is the local exchange bottleneck, the Government would not have accomplished very much by spinning off the bottleneck and then letting it build back into the Bell System. Divestiture and the injunctions were two sides of the same coin; otherwise, we would have a situation in which we would have soon regenerated all the controversy we set out to solve.

We are three and a half years down the road from divestiture, and we are looking back and we are seeing that the effects of the decree were exactly as predicted in these competitive marketplaces.

With clearer rules and fewer causes for controversy, we have an industry where long distance competitors number in the hundreds, and so do competitive manufacturers. This country is the most open market in the world, and the prices of long distance service and products have fallen dramatically.

In keeping with the Sherman Act foundation, we have a decree that has been pro-competitive and pro-consumer. Now, we are over in the District Court in the first of what are to be three-year reviews of whether these line-of-business injunctions still serve their purposes. And we have pending before that court and in some quarters of Congress, proposals to revisit those injunctions and do away with some of them.

AT&T does not oppose those proposals which do not affect the core of the decree. But as to those core injunctions, the injunctions on long distance and manufacturing, Mr. Chairman, we find no reason to make any fundamental change in antitrust policy. The reason is, nothing has changed in the basic antitrust facts in law that led to this decree in the first place.

First, the Sherman Act has not been repealed, nor has the bottleneck theory. If I may wrap up for just a second, Mr. Chairman, the bottlenecks themselves still exist in a big way. The Department of Justice's report said that long distance competitors use local telephone company lines to reach 99.9999 percent of their long distance customers. In these situations, Mr. Chairman, we think it would be a bad thing, a bad antitrust policy to do away with the injunctions. We have a decree which, in its fundamentals, is working well. And we do not think there is reason to change it.

Thank you very much.

[Prepared statement follows:]

SUMMARY OF REMARKS
BY JOHN D. ZEGLIS, AT&T
BEFORE THE U.S. SENATE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS
APRIL 30, 1987

AT&T's January 1, 1984 divestiture of the RBOCs and the Decree's line of business injunctions are opposite sides of the same antitrust coin. Each is the product of 35 years of litigation against the Bell System. Each was proposed by the Justice Department, adopted by the District Court, and affirmed by the Court of Appeals and the United States Supreme Court. Each rests on explicit antitrust findings that the seven RBOCs' participation in competitive markets would present profound competitive problems, harm consumers, and threaten the health of the national telecommunications industry. Each rests on findings that regulation cannot solve this antitrust problem so long as the RBOCs' local exchanges are "bottleneck monopolies" -- as they unquestionably are today.

Under the line-of-business injunctions, competition has flourished in the long distance and manufacturing markets that are at the heart of the Decree. This competition has produced the very consumer benefits that is the purpose of the antitrust laws to foster: reduced rates, lower prices, and wider choices of products and services for consumers.

There is no reason or basis for Congress to remove the Decree's line-of-business injunctions. The Justice Department agrees that the RBOC's have the same ability to leverage bottleneck monopolies into long distance and manufacturing markets as they did the day the Decree was entered. Indeed, even with the Decree's protections there have been instances in the last three years in which RBOCs have attempted to use their exchange monopolies to foreclose competition with RBOC services. The fact that the Decree Court has provided swift remedies against this misconduct is compelling evidence of the need for the Decree's injunctions. Elimination of the injunctions would remit injured competitors to again instituting scores of costly and time-consuming antitrust suits and recreate the controversies that paralyzed the telecommunications industry in the decade that led to divestiture. Removal of the injunctions would further subvert such vital national objectives as protecting universal service, promoting America's international competitiveness and foreign trade, and preventing balkanization and fragmentation of the national telephone network.

STATEMENT OF JOHN D. ZEGLIS

Mr. Chairman and members of the Subcommittee: My name is John D. Zeglis. I am Senior Vice President and General Counsel of American Telephone and Telegraph Company ("AT&T"). We greatly appreciate the Committee's invitation to appear today to discuss the competitive issues in the telecommunications industry and the legislative proposals to modify the AT&T Antitrust Decree by eliminating some or all of its line of business injunctions on the divested Regional Bell Operating Companies ("RBOCs").

These proposals present critical issues under the nation's antitrust laws. The Sherman Act exists to promote consumer welfare. The Decree and its line of business injunctions were proposed by the Justice Department, adopted by a Federal District Court, and affirmed by the United States Supreme Court, to implement the Sherman Act. The injunctions rest on explicit antitrust findings that the seven RBOCs' participation in specific markets would present profound competitive problems and threaten the health and growth of a vital national industry so long as the RBOCs' local exchanges are "bottleneck monopolies" -- as even today's Justice Department has repeatedly found that they are. These findings were compelled by the record compiled by the Justice Department and over 600 commentors in the proceedings that led to the Decree.

Experience has vindicated these antitrust findings. Under the Decree and its line of business injunctions, competition has flourished in the long distance and manufacturing markets that are at the heart of the Decree. And this competition has produced the very consumer benefits that it is the purpose of the antitrust laws to foster: lower prices, reduced rates, and a wider choice of products and services for consumers. In short, the Decree has proved to be both procompetitive and proconsumer. In contrast, to eliminate the Decree's core injunctions today, while the bottlenecks remain, would threaten to nullify these benefits, recreate the turmoil, instability and paralysis that the Decree sought to end, and impair other vital national interests.

My testimony is divided in three parts. First, it will discuss the antitrust basis and background for the AT&T Decree and why the Decree's provisions were found to be essential to protect competition and consumers. Second, it will describe how the experience of the last three years has witnessed the very competitive, consumer, and ratepayer benefits that it is the purpose of the antitrust laws to create. Third, it will explain that there have been no intervening changes in the fundamental circumstance that is the premise for the Decree's core injunctions (the bottleneck character of the RBOCs' local exchanges) and no reason to consider legislation to upset this prudent use of antitrust remedies. This is especially so because the Decree Court will reconsider the Decree's injunctive protections under antitrust standards as circumstances warrant -- and is conducting such proceedings now.

I. THE ANTITRUST BASIS FOR THE DECREE.

The AT&T Decree granted the United States the precise structural antitrust relief that the Justice Department sought in over three decades of antitrust litigation with the formerly-integrated Bell System. The January 1, 1984, divestiture split the Bell System between its monopoly exchange businesses (assigned to the RBOCs) and its competitive long distance and manufacturing businesses (assigned to AT&T). The Decree's line of business injunctions on the divested RBOCs, in turn, assure that the RBOCs may not recreate the very combinations and controversies that divestiture ended. At the same time, this antitrust relief was carefully fashioned to create an industry structure for telecommunications that would not only promote competition in long distance, manufacturing, and other markets, but also protect ratepayers, prevent balkanization of the national network, and promote America's international competitiveness and balance of payments.

The line of business injunctions and the January 1, 1984, divestiture of the RBOCs have thus been held to be "necessary complements" to one other. Each is essential to the implementation of the antitrust leveraging theory that was the basis for the prior 35 years of litigation. Each was agreed to by AT&T as the best of the alternatives in 1982. Each was broadly supported by the 600 commentors that participated in the public interest proceedings that led to the Decree. And each rests on a fact that has now been recognized by judges ranging from District Judge Harold H. Greene, to the Court of Appeals for the District of Columbia Circuit, to the United States Supreme Court: that the dual control of local exchange bottlenecks and competitive interexchange, manufacturing, and other closely-related businesses that depend on "access" to the bottlenecks creates profound competitive controversies and threatens vital national interests. Indeed, when District Judge Harold H. Greene entered the Decree in 1982, he departed from this antitrust theory in only minor respects -- each of which relaxed the restrictions on the RBOCs by allowing them to enter certain competitive businesses that were not at the heart of the decades of antitrust litigation.

These points are demonstrated by a brief review of (1) the antitrust litigation against the Bell System, (2) the fact that state and federal public utility regulation could not prevent these controversies, (3) the enormous costs that this antitrust problem imposed on the Nation, and (4) the explicit antitrust findings that the District Court made when the Decree was entered and that appellate courts have since reaffirmed.

1. The 1949 And 1974 Government Antitrust Cases And The More Than 70 Private Suits

Prior to 1984, the Bell System had been a single enterprise that participated in monopoly and related competitive businesses alike. Through the Bell Operating Companies ("BOCs"), the Bell System owned the local telephone exchanges, which everyone recognized were natural monopolies that could not feasibly be duplicated. Through AT&T and Western Electric, the Bell System also participated in three actually or potentially competitive businesses that depended on access to the local "bottlenecks": (1) long distance ("interexchange") services, which require access to local telephone facilities to originate and terminate calls; (2) the manufacture of telecommunications equipment (including equipment located on customer premises), most of which was purchased by BOCs and all of which requires access to information about the evolving technical characteristics of monopoly local exchanges; and (3) the provision of a very few "information services" (i.e., time, weather, and sports information), which similarly require use of local telephone facilities for transmission of the information.

In the 35 years that led to the Decree, the United States brought two separate antitrust actions to break up the Bell System in 1949 (United States v. Western Electric, No. 17-49 (D.N.J.)) and in 1974 (United States v. AT&T, No. 74-1698 (D.D.C.)). The basis for each was the Department's contention that the structure of the Bell System was inherently anticompetitive.

The Department proceeded under the theories that a firm with a lawful monopoly violates Section 2 of the Sherman Act if it "leverages" that monopoly to impede or foreclose any substantial competition in a related market -- even if the firm neither monopolizes nor could attempt to monopolize that second market[1] -- and that a monopolist acquires special duties if it controls an "essential facility" or a "strategic bottleneck" to which competitors require nondiscriminatory access. As Judge Harold Greene and other courts have found, this dual control over telephone monopolies and related competitive business gave the Bell Companies the "ability" and "incentive" to foreclose competition in both long distance and equipment manufacturing markets -- through discrimination and cross-subsidization. E.g., United States v. AT&T, 552 F. Supp. 131, 187 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983); Litton Systems, Inc. v. AT&T, 700 F.2d 785, 798-802 (2nd Cir. 1983), cert. denied, 404 U.S. 1073 (1984).

Equipment Manufacturing. In both the 1949 and the 1974 cases, the Department claimed that the Bell System's control over local telephone monopolies inherently foreclosed competition in equipment manufacturing markets. In the Department's view, the Bell System could, and had, misused its local monopolies to foreclose competition in these markets in three different ways.

First, in numerous episodes in United States v. AT&T, the Department charged that the BOCs and their centralized engineering affiliate (Bell Telephone Laboratories) had "discriminated" against the Bell System's manufacturing competitors in providing access to essential information about monopoly networks. Specifically, the Department contended that the Bell manufacturing affiliate (Western Electric) had been provided with preferential access to technical data, compatibility standards, information about the BOCs' needs and requirements, and other information about the evolving characteristics of the local exchange bottlenecks that is essential to the manufacture of equipment for sale to BOCs. See Plaintiff's Memorandum in Opposition to Defendant's Motion For Involuntary Dismissal, United States v. AT&T, No. 74-1698 (D.D.C.), pp. 49-51, 296-359, 366-410 (August 16, 1981) (hereinafter cited as "August 16, 1981, DOJ Memorandum"); Competitive Impact Statement, United States v.

AT&T, No. 74-1698 (D.D.C.), p. 15 (February 10, 1982) (hereinafter cited as "Competitive Impact Statement").

For example, the Department alleged that, "[b]y setting technical or compatibility standards and by either not communicating these standards to the general trade or changing them in mid-stream," the Bell System gave its manufacturing affiliate a "headstart" and insuperable advantages in designing equipment for use with the BOCs' local exchanges (United States v. AT&T, 524 F. Supp. 1336, 1372 (D.D.C. 1981)). This headstart allegedly assured that Western Electric would have the only products on the market that met BOC requirements -- such that the product could be purchased at inflated prices and regulatory authorities had no realistic alternative to passing these inflated prices through to ratepayers. See August 16, 1981, DOJ Memorandum, pp. 49-51; Competitive Impact Statement, pp. 15, 40-42.

Second, the Department claimed that the BOCs had "subsidize[d] the prices of their equipment with the revenues from their monopoly services" (United States v. AT&T, 552 F. Supp. 131, 190 (D.D.C. 1982)); this allegedly permitted BOC sales to CPE customers below cost or without regard to cost -- or Western Electric sales to BOCs themselves at below-cost prices when necessary to assure that Western Electric products would be selected. Specifically, the Department and others charged that the product design and development expenses of Western Electric had been misallocated to the systems engineering and research functions that were funded by the BOCs' payments to AT&T under the License Contract. See, e.g., Plaintiff's First Statement of Contentions and Proof, United States v. AT&T, No. 74-1698 (D.D.C.), p. 53 (November 1, 1978); August 16, 1981, DOJ Memorandum, pp. 366, 389-91; Competitive Impact Statement, pp. 40-42. This conduct would produce both predatory pricing that harmed competition and inflated rates that harmed consumers.

Finally, the Department claimed that when Western Electric's "privileged access to information [and other conduct] failed to foreclose competition," the BOCs would simply favor their affiliate's products, even when better or cheaper alternatives were available from unaffiliated vendors. August 16, 1981, DOJ Memorandum, pp. 28-33, 376-88, 402-10; Competitive Impact Statement, p. 15. Episode after episode in United States v. AT&T charged this misconduct and alleged the monopoly character of the RBOCs' exchanges gave them the ability to buy equipment at inflated prices, to the detriment of competition and consumers alike. The Department argued such a use of vertical integration to "evade" rate regulation and inflate consumers rates was a per se violation of Section 2 of the Sherman Act under Byars v. Bluff City News, 609 F.2d 843, 861 (6th Cir. 1979); 3 P. Areeda & D. Turner, Antitrust Law 218-19 (1978), and other like authorities. See August 16, 1981, DOJ Memorandum, pp. 362-364.

The Department did not base its claims solely on allegations of the Bell System's actual conduct. The Department further contended that the mere existence of the vertically integrated Bell System created "suspicions" that would inhibit competition, whether or not the Bell System in fact engaged in any anticompetitive abuses. The Department claimed that, whether due to the efficiencies of integration or the perceived likelihood of abuses, firms would be inhibited from entering the American market and selling products to the BOCs so long as they were affiliated with a manufacturer. See United States v. AT&T, 524 F. Supp. at 1379-1380 (quoting August 16, 1981, DOJ Memorandum, p. 51).

Interexchange Services. The Bell System's control over exchange monopolies produced equally intractable controversies in the interexchange markets. The Department contended -- and AT&T could not dispute -- that the local Bell exchanges monopolies are "essential facilities" for all participants in this market. The reality is that no long distance carrier can compete in this market unless it obtains the local loops and other local distribution facilities that connect its intercity network to consumers. Because these RBOC facilities are a "natural monopoly" that no interexchange carrier can feasibly duplicate, all interexchange carriers are absolutely dependent on obtaining access to these local bottlenecks in a timely fashion and at reasonable and nondiscriminatory prices. The Department thus relied on a line of cases holding that firms controlling strategic bottlenecks must provide access to them on nondiscriminatory terms.[2]

Indeed, the allegations in the many episodes in United States v. AT&T set forth a vast array of charges that Bell System companies had abused local bottlenecks to impede interexchange competition. Bell companies were charged with denying intercity competitors access to essential facilities; discriminatory pricing of essential facilities; negotiating in bad faith over new forms of interconnection to those facilities; misallocating joint and common costs between monopoly and competitive services to "cross-subsidize" interexchange services; engaging in "price squeezes" by charging inflated rates for local access while simultaneously lowering interexchange rates; delaying release of the interface information that long distance carriers need to develop new services; and continually "shifting from one anticompetitive activity to another." United States v. AT&T, 552 F. Supp. at 167; See, August 16, 1981, DOJ Memorandum, pp. 67-285; United States v. AT&T, No. 74-1698, Plaintiff's First Statement of Contentions and Proof, pp. 74-258 (November 1, 1978). In the Department's view, all this actual or possible conduct foreclosed competition, inhibited entry, and injured consumers and competition alike.

These allegations were not limited to Government antitrust suits. More than 70 private antitrust cases were brought against Bell companies under these same leveraging theories by interexchange carriers,[3] equipment manufacturers,[4] and other competitors.

2. Regulation

A principal Bell System defense to these antitrust charges was that, almost without exception, all the challenged conduct was not only subject to regulation, but had actually been reviewed or approved by the FCC and the state utility commissions that regulated Bell System companies.

Indeed, the existence of this regulation had been the basis for the 1956 Judgment that settled the Department of Justice's 1949 complaint. At the time of the 1949 Complaint, competition in telecommunications was limited to equipment manufacturing, and the Department of Justice complaint prayed that the Bell System be ordered to divest Western Electric and then be perpetually enjoined from manufacturing equipment. However, in the 1956 Judgment, the parties stipulated to the entry of a judgment that did not order any structural relief, but sought to control the Bell monopoly by limiting the Bell System to providing regulated services and to manufacturing equipment of the kind used for such regulated services -- while relying on regulation to prevent controversies and abuses.

However, it became apparent that neither the 1956 Decree nor state and federal regulation could prevent future controversies over the claimed abuses of local exchange monopolies, especially when competition thereafter was introduced into interexchange services and other aspects of the equipment business.

In the 1974 government case and over 70 private cases brought in the decade that led to the Decree, courts uniformly held that the existence of regulation under the public interest standard of the Communications Act of 1934 (or similar state statutes) could not immunize Bell companies' conduct from suits challenging that same conduct under the separate "competitive" standard of the Sherman Act.[5]

The Department of Justice also introduced evidence to prove that the local telecommunications network is so complex, so technologically dynamic and characterized by such great joint and common costs that existing forms of public utility regulation simply could not prevent disputes or abuses. Regulation, it claimed, could not prevent discrimination in pricing and provisioning of bottleneck facilities to interexchange carriers, discrimination in providing interface information and specifications for new products to equipment manufacturers, discrimination in the procurement of equipment, or misallocation of the Bell System joint and common costs between competitive and monopoly activities. See, e.g., August 16, 1981, DOJ Memorandum, pp. 46-47, 125 n.*, 161-62, 281-82, 285, 374.

3. The Social Costs Of The Antitrust Problem

The Bell System vigorously defended all the conduct that was challenged in the more than 70 public and private antitrust cases -- and AT&T believes to this day that the conduct was reasonable. However, the litigation demonstrated that the mere fact of the integration of exchange and competitive businesses would continue to create antitrust controversies that threatened the Bell System, its shareholders, and the health and growth of a critical national industry -- no matter who won the pending cases.

First, the dual control of monopoly bottlenecks and competitive assets created inherent antitrust exposure -- and the certainty of enormous litigation costs. No single verdict could ever end the controversies. No matter who won

United States v. AT&T and the other pending cases, the exposure to these antitrust charges was inherent in the integrated structure of the Bell System. Under that leveraging theory, virtually any competitive success of AT&T -- or failure by a competitor -- could be challenged in an antitrust court. A competitor could always claim that AT&T's success resulted from the misuse of its bottlenecks, not the efficiencies of integration, and in each case the allegation would raise a question of fact that would have to "go to the jury."

More fundamentally, the Bell System's integration of bottleneck monopolies and related competitive businesses did more than create antitrust exposure that increased the Bell System's costs of doing business. They led to incessant antitrust, regulatory, and legislative proceedings that were designed to establish regulations that would prevent abuses of the local bottlenecks and thereby establish more level playing fields.[6] The Bell System was confronted not only with the claims in United States v. AT&T, but also with the injunctive demands in private antitrust suits, a host of proposed and actual FCC regulations, and legislative proposals that sought to limit the Bell System's ability to abuse its bottleneck through devices ranging from procurement quotas, to information flow rules, to interconnection standards, to pricing regulations. These initiatives, too, were attributable to the Bell System's dual control of monopoly and competitive businesses.

As the District Court found in 1982, the mere existence of the litigation and the uncertainty over industry structure and ground rules threatened the entire industry and the legitimate interests of all its participants. See United States v. AT&T, No. 74-1698, Order (April 8, 1982), pp. 5-6. For while the regulatory, legislative, and antitrust initiatives were pending, the industry participants had to wait, month after month, year after year, to learn what the "rules" and industry structure would be. While they waited, industry participants often could not move forward with new services and new investment, for fear of having to backtrack when the new "rules" were determined. Worse, industry participants bent their efforts toward prosecuting or defending the litigation (or agency or legislative proceedings) in order to influence the resulting "rules" to each participant's best advantage. Finally, the Department of Justice contended that the mere existence of the integrated Bell System inhibited many firms from even entering the long distance and equipment manufacturing markets in competition with AT&T. See p. 10, supra.

In short, the costs of dispute dragged down all industry participants -- large and small companies, actual and potential investors, and customers of all sizes.

Under the bottleneck leveraging theory, there was only one antitrust remedy that could end the crippling uncertainty and incessant controversies: AT&T's divestiture of the local exchange operations of the BOCs and the imposition of corresponding line of business injunctions that would prevent the divested RBOCs from reentering competitive businesses. The Department sought this precise remedy in its 1974 case, both in the pretrial proceedings and at trial -- through three different Administrations and the tenures of five different Attorneys General. The fact that this antitrust remedy was dictated by the antitrust theory of the United States is vividly illustrated by the cover note that the then Assistant Attorney General for Antitrust (William Baxter) attached to the first draft of the Decree. It made one demand that was "non-negotiable": "the concept of separating the local exchange functions & confining the BOCs to local exchange functions." (December 21, 1981).

Thus, the Department contended that divestiture and the Decree's line of business injunctions are "necessary complements" to one another and that the Decree's line of business injunctions are the "opposite side of the divestiture coin, . . . an integral part of the divestiture, . . . and proceed on precisely the same theory [as divestiture]."[7]

4. The Court's Antitrust Findings Under The Tunney Act.

Although the Decree was not AT&T's idea, AT&T decided that it was the best of the available alternatives and the only way to end the turmoil and industry paralysis. On January 8, 1982, AT&T thus consented to entry of a decree that would radically restructure the Bell System, and the nation's telecommunications industry, by adopting the very relief that the Department insisted upon. Before this Decree could be entered, however, the Tunney Act required Judge Greene to conduct extensive proceedings to determine whether the relief proposal was in the public interest and to make explicit antitrust findings on the appropriateness of this remedy.

Over 600 entities submitted written comments, including competitors in each of the relevant markets, the FCC, state utility commissions, public interest groups, and members of Congress. The commentors almost uniformly agreed that divestiture was a good idea. They also almost uniformly agreed with the concept of line of business injunctions on the divested RBOCs, although some commentors challenged some of the injunctions that the Department had proposed.

On the basis of this record and the voluminous trial record, Judge Greene made the findings that were required -- as any District Judge would have.

Judge Greene found that AT&T's divestiture of the RBOCs was "plainly in the public interest." United States v. AT&T, 552 F. Supp. 131, 223 (D.D.C. 1982). Judge Greene similarly approved the line of business injunctions that would prevent the divested RBOCs from reentering the interexchange and manufacturing markets that were the subject of the 35 years of litigation. The Court found that the interexchange services injunction was necessary because access to the RBOCs' local exchanges is "essential" for interexchange carriers and any RBOC that provided these services could disadvantage interexchange carriers in a variety of ways so long as exchanges remained monopolies (552 F. Supp. at 188). The Court concluded that the equipment manufacturing injunction was necessary because "[t]here is a substantial likelihood" that RBOCs would "frustrate" competition by nonaffiliated manufacturers if RBOCs were not enjoined (552 F. Supp. at 190). At the same time, although the Court recognized that the information services market was evolving and uncertain, it found that BOCs should then be excluded from this market "for reasons similar to those justifying the restriction on interexchange service." 552 F. Supp. at 189.

In upholding these injunctions, the court rejected arguments that the existence of seven independent RBOCs or state and federal regulations could eliminate the need for the line of business injunctions in the Decree. The Court held that insofar as these injunctions and the threatened injuries to "competition, competitors, and ratepayers" are concerned, it is a "distinction . . . without a difference" that "the 'old' Bell System . . . was nationwide in scope while each of the seven Regional Companies possesses an equally powerful monopoly in [only] a particular geographic region." United States v. Western Electric, 627 F. Supp. 1090, 1095 (D.D.C. 1986). The Court held that "[i]f regulation could effectively prevent the [anticompetitive] practices [by these companies], there would have been no need for the AT&T action." United States v. AT&T, 552 F. Supp. at 187 n.229. See also United States v. Western Electric Co., 627 F. Supp. at 1097 n.22; id., 592 F. Supp. 846, 855 & n.20 (D.D.C. 1984).

There is only one respect in which Judge Greene departed from the strict quarantine theory of the Department and the leveraging theory that it and the commentors embraced: Judge Greene loosened the proposed injunctions on the RBOCs and allowed them to participate in certain "noncore" businesses. Judge Greene rejected the Department's proposal to enjoin RBOCs from providing "customer premises equipment" and "Yellow Pages" in connection with local exchange service. (United States v. AT&T, 552 F. Supp. at 191-93 & 193-94).

Judge Greene further modified the Decree's fourth line of business injunction: the "catch-all" injunction that excludes them from all businesses other than local exchange telephone services. Under the Department's proposal, this "catch-all" injunction would have absolutely limited the RBOCs to local telephone service and absolutely barred their participation in any other businesses, no matter how "unrelated," with no opportunity for waivers. 552 F. Supp. at 195 n.267. Although he found that the RBOCs could "leverage" bottlenecks into some such markets, Judge Greene did not impose this blanket injunction. Instead, he established a flexible "waiver" procedure under which RBOCs could enter businesses (other than long distance, manufacturing, or information services) upon a showing that leveraging was not possible. Over 100 such waivers have been granted to date. Ironically, this process has provoked charges that Judge Greene is a "regulator." However, it would have been a traditional antitrust remedy if Judge Greene had adopted the Department's proposal and flatly excluded the RBOCs from these noncore businesses altogether. Yet the RBOCs would have been more restricted in that event.

At the same time, the Court held -- and repeatedly reiterated after divestiture -- that removal of the core interexchange and manufacturing injunctions would be governed by the bottleneck leveraging theory that is the basis for the Decree (United States v. AT&T, 552 F. Supp. at 195) and that he would not even consider proposals to allow RBOCs to participate in the core interexchange and manufacturing businesses unless and until their local exchanges cease to be bottleneck monopolies:

> "The Court will not even consider the substantive merits of a waiver request seeking permission to provide interexchange services until such time as the Regional Holding Companies lose their bottleneck monopolies and there is substantial competition in local telecommunications service.
>
> . . .
>
> Similar considerations govern the appropriateness of entry of the Regional Holding Companies into the information services and equipment manufacturing markets. No significant technological or structural changes have occurred in these markets to justify a relaxation of these line of business restrictions, and no requests for waivers in these markets will be considered unless and until such changes have taken place" (emphasis added). (United States v. Western Electric, 592 F. Supp. at 868 & n.90).

Finally, in approving the Decree, Judge Greene exercised the remedial authority he possessed to fashion an antitrust remedy and create an industry structure that would not only promote competition in the long distance and manufacturing markets, but also secure such important national objectives as protecting ratepayers and preserving AT&T as a dynamic force capable of competing in national and international markets, thus fostering a more favorable balance of payments:

> "To the extent that it has been free to do so, the Court, in exercising its Tunney Act responsibilities, has sought to achieve three principal objectives: (1) promotion of true and fair competition in the telecommunications long distance and equipment markets, (2) preservation of AT&T as a dynamic force, capable of research, manufacturing, and marketing in technologically advanced fields, and (3) protection of the principle of universal telephone service, accessible to all segments of the population regardless of income." United States v. Western Electric, 569 F. Supp. 1057, 1120 (D.D.C. 1983).

Thus, Judge Greene (1) refused to impose procurement quotas that would foreclose AT&T from any portion of the

RBOC market (United States v. AT&T, 552 F. Supp. at 173-74), emphasized that AT&T could make sales to RBOCs on the basis of price and quality (552 F. Supp. at 174 & n.183), and otherwise sought to promote foreign trade and a more favorable balance of payments (552 F. Supp. at 180; United States v. Western Electric, 604 F. Supp. 256, 261 (D.D.C. 1984)); (2) approved the centralized engineering by the RBOCs that was found to be essential to the "very survival" of the national telephone network (id., 569 F. Supp. at 1113-18); and (3) retained line of business injunctions that would prevent disputes over cross-subsidization and inflated rates (id., 592 F. Supp. at 853-55) and assure the cooperation among local and long distance carriers that is essential to reliable service (id. at 861-67). The Court found that all these objectives would be furthered by the Decree, and its "prophylactic measures" that prevent even the possibility that RBOCs could enter related competitive markets while their local exchanges are bottleneck monopolies. 592 F. Supp. at 869.

The Decree, with its line of business injunctions and the explicit standard for their removal, was affirmed by the United States Supreme Court. Maryland v. United States, 460 U.S. 1001 (1983). And the appropriateness of this antitrust remedy was recently reaffirmed by the Court of Appeals for the District of Columbia Circuit, in a panel of Circuit Judge James Buckley, Circuit Judge (now Justice) Antonin Scalia, and Circuit Judge Abner Mikva. United States v. Western Electric Co., 797 F.2d 1082 (D.C. Cir. 1986), cert. denied, 107 S. Ct. 1384 (1987). As Judge Buckley's Opinion stated (797 F.2d at 1088):

> "We are not troubled by U.S. West's observation that the decree's expansive definition of a BOC results in broad application of the decree's [line of business injunctions and] restrictions to [RBOCs] and other companies affiliated with BOCs. This result is consistent with the decree's objective of sharply limiting the ability of businesses with bottleneck control of local telephone service to utilize their monopoly advantages to affect competition in competitive markets. United States v. American Telephone and Telegraph Co., 552 F. Supp. at 142."

II. COMPETITION IN THE POST-DIVESTITURE TELECOMMUNICATIONS INDUSTRY

Experience since divestiture has demonstrated that the Decree is working. The industry structure that it created *has* allowed "more rapid and certain development of competition" in the interexchange and manufacturing markets in precisely the way that the Department and the Decree Court found that it would. Competitive Impact Statement, p. 8; *see* *United States* v. *AT&T*, 552 F. Supp. 131, 160-166, 222-224 (D.D.C. 1982). As the former Chief of the Antitrust Division of the Justice Department stated last year, these markets have experienced "the introduction, at an unprecedented pace, of innovative products and services coupled with dramatic price reductions" in the three years since divestiture.[8]

The developments and consumer benefits in the interexchange markets could scarcely be more dramatic. New long distance companies have entered this market "in reliance upon the competitive safeguards and industry structures provided in the Consent Decree," and especially on the fact that the Decree assures that owners of essential exchange bottleneck facilities may not compete in this market. Comments of National Communications Network, *United States* v. *Western Electric*, No. 82-0192, p. 4 (March 13, 1987). Today, there are some 475 interexchange carriers in competition with AT&T, and these interexchange carriers have constructed over 1.7 billion circuit miles of transmission capacity -- far in excess of AT&T's roughly one billion circuit miles.[9] Indeed, MCI and US Sprint contend that competition in the interexchange telecommunications market is so intense that AT&T has no market power, and MCI even urges deregulation of the entire market. *See* Comments of MCI in FCC CC Docket 86-421 (March 6, 1987).

The benefits to consumers have been extraordinary. Interexchange rates have declined 30% since divestiture. Consumers have a choice of long distance carriers, and interexchange carriers have developed and are introducing new services that benefit residential customers (e.g., AT&T's "Reach-Out America" and "Call Me" plans); small business customers (e.g., AT&T's "Pro-America" plan); and large customers (e.g., AT&T's Software Defined Network) at breakneck speeds.

The Decree has had the same effect in the telecommunications equipment manufacturing market. As one industry analyst recently remarked, the United States equipment market consists today of AT&T, "a half-dozen towering international firms, . . . plus one to two hundred key smaller firms of diverse heights and architecture," plus literally hundreds of even smaller recent entrants.[10] Indeed, since divestiture, new firms have entered the American market to supply residential telephones, key systems, private branch exchanges, central office switches, and transmission equipment; prices for each of these types of equipment have dropped; and RHCs are continually establishing relationships with new suppliers.

The former Chief of the Antitrust Division recognized all these developments in his testimony in Congress last Fall:

> "[It has been] estimated that the per-line price of key telephone systems would decrease by 25 percent in 1985 alone, at the same time as technological advances made such systems more versatile than ever before. In the market for telecommunications equipment, the per-line price of certain central office switching equipment has been cut in half. And in the market for long-distance services, AT&T for example has reduced its rates time and again, making the price of direct-dialed calls 25 percent lower than it was at divestiture; indeed, for certain large customers, AT&T's long distance charges are only one-half of what they were at that time. Finally, while the price of flat-rate local exchange service has increased by approximately 25 percent in the first two years after divestiture, this increase is better explained by other factors, such as inflation and regulatory changes, that have nothing to do with divestiture. On balance, both residential and business customers are paying less for their overall telephone service than they were prior to divestiture by taking advantage of the new competitive environment." Ginsburg, supra, p. 4.

Against this background, it is not surprising that consumers have been the most virulent opponents of any modification of the Decree's interexchange and manufacturing injunctions. In the pending proceedings in the Decree court, representatives of small customers (e.g., the Consumer Federation of America) and large customers (e.g., Ad Hoc Telecommunications Users Association and International Communications Association) have uniformly opposed any relaxation of these injunctions and have made extensive arguments that the Decree's line of business injunctions on the RBOCs are essential to consumer welfare.

III. THERE HAVE BEEN NO CHANGED CIRCUMSTANCES THAT COULD PERMIT MODIFICATION OF THE DECREE

The Decree has so clearly achieved the procompetitive and proconsumer objectives of the antitrust laws in the interexchange and manufacturing markets that were at issue in United States v. AT&T that it is unclear why anyone would propose that these line of business injunctions on the RBOCs be eliminated. And there is no reason or basis to do so. The Sherman Act and the antitrust laws have not been repealed, and the RBOC bottlenecks that are the reason for this antitrust decree remain. To eliminate the injunctions would simply recreate the incessant antitrust controversies, paralysis, and threats to a vital national industry that this antitrust decree sought to end.

Indeed, the compelling need for the Decree's line of business injunction has been demonstrated in the three years since divestiture. Even with the Decree, there have been instances in which RBOCs have attempted to use their exchange monopolies to foreclose competition with RBOC services. The Decree has provided swift remedies against this conduct. To adopt the proposals to eliminate the injunctions, in contrast, would not only multiply the potential for controversies and abuse many times, but also require injured competitors to seek to remedy misconduct by again instituting costly and time-consuming antitrust suits -- which is the precise event that the antitrust remedies in government suits are supposed to prevent.

There similarly is no reason to consider legislation that would affect the Decree's information services prohibition or its "catchall" provision that bars the RBOCs from participating in businesses other than local exchange services unless and until the District Court determines that the RBOCs cannot realistically "leverage" their local monopolies into the particular market. These injunctions, too, are based on antitrust findings. At the same time, these injunctions involve markets that were not at issue in the 35 years of antitrust litigation that led to the Decree, and many persons (including AT&T) are presenting evidence and arguments to Judge Greene that these injunctions are "overbroad" and perhaps can now be modified in certain respects without subverting the antitrust laws. These questions, and the issues whether and to what extent local monopolies can be leveraged into these markets, are peculiarly matters for the expert judgment of an antitrust court and are committed to its remedial powers. There is no reason to consider legislation on these issues.

Finally, elimination of the line of business injunctions would unavoidably subvert the Decree's additional objectives of promoting universal service, preventing balkanization of the national telephone network, and furthering America's international competitiveness.

These points will be developed in greater detail by demonstrating (1) that there has been no change in circumstances that would justify removal of the line of business injunctions, (2) that the experience of the past three years has demonstrated that the Decree promotes competition, and (3) that the proposals to eliminate the Decree's core injunctions would imperil other vital national interests.

1. There Have Been No Material Change In Circumstances Since The Decree Was Entered

First, there has been no change in the single circumstance that is the basis for the Decree and its line of business injunctions: the fact that the RBOCs' local exchanges are bottleneck monopolies. Even today's Justice Department has repeatedly found that the RBOCs' exchanges are as much a monopoly as they were the day the Decree was entered. For example, in the Report that proposes eliminating all the line of business injunctions on the RBOCs, the Department found that RBOCs provide access for 99.9 percent of interexchange carrier traffic and 99.9999 percent of interexchange carrier customers. Report and Recommendations of United States, *United States* v. *Western Electric*, No. 82-0192, p. 80 (hereinafter cited as "Department's Report"). Several weeks later, the Department stated repeatedly that the RBOCs' local exchanges are "bottleneck monopolies" in a filing made to the FCC. Comments of United States, CC Docket 86-421, pp. 4-22 (March 6, 1987). Thus, there is no basis to eliminate the injunctions.

Today's Justice Department, however, has advanced a number of arguments under which the injunctions can be removed, despite the RBOCs' conceded bottlenecks. None withstands even cursory analysis.

The Department's major contention is that state and federal regulation is now adequate to prevent antitrust controversies or abuses, especially because the Decree created seven RHCs that allegedly create "benchmarks." However, the Decree Court has repeatedly rejected this "benchmark" argument (*see* p. 21, *supra*), and there has been no change in the character of public utility regulation in the past three years. To the contrary, the regulations that the Department relies upon -- the FCC's Part 68 Registration requirements for Customer Premises Equipment ("CPE"), the FCC's *Computer II* CPE regulations, the FCC's Fully Distributed Cost Allocation rules, and the FCC's Computer III information service regulations -- either were in existence when the Decree was entered or are weaker versions of the earlier FCC regulations.

Perhaps more importantly, decades of litigation under the Sherman Act establish that even "perfect" regulation by the FCC under a broad public interest standard cannot solve the separate antitrust problems caused by dual control of bottlenecks and related competitive businesses. See pp. 13-15, supra.

The Department has also argued that the antitrust problem in the interexchange market stems solely from the fact that state commissions regulate entry and resale of RBOC local exchange services, and the Department proposes that the injunctions should be eliminated whenever state regulatory commissions eliminate these regulatory restrictions. These contentions are misguided. The basis for the 35 years of antitrust litigation is the fact that RBOCs' "local loops" (which are buried under streets or strung along telephone poles) and other local distribution facilities cannot feasibly be duplicated and are thus natural monopolies and bottlenecks, regardless of whether interexchange competitors and others have a legal right to attempt to do so under state regulations. See pp. 10-11, supra. Thus, parties ranging from state commissions (Public Service Commission of District of Columbia), to small customers (Consumer Federation Of America), to large consumers (Ad Hoc Telecommunications Users Committee), to independent local telephone companies (Organization for the Protection and Advancement of Small Telephone Companies), to interexchange carriers (MCI), have sharply criticized this aspect of the Department's proposal in their recent filings in the Decree Court.

In a similar vein, the Department has contended that increases by large business in the use of customer premises equipment known as Private Branch Exchanges ("PBXs") will someday transform the telephone network into a "geodesic network" in which customers and interexchange competitors will no longer depend on RBOC bottleneck monopolies. These contentions are also without merit. PBXs were in existence when the Decree was entered (in fact 100% of large business customers used PBXs in the 1960s before Centrex was developed) -- and the extent to which PBXs are or are not used has no pertinence to the relevant antitrust issues. The fact is that PBX customers still depend almost exclusively on the RBOC bottleneck local loops and local distribution networks to place and receive long distance calls and local calls. The question, moreover, is not whether the RBOCs monopolies will end someday. It is whether they have ended today, and they indisputably have not.

The Department has also relied on the fact that the RBOCs have largely complied with the Decree's separate requirement that they convert their local networks to allow customers to "presubscribe" to whatever long distance company that they choose and reach that company by simply dialing "1". Under the Decree, these "equal access" conversions do not permit elimination of the interexchange prohibition, for the Decree orders both the network conversions and the ban on RBOC participation in long distance markets while they control bottlenecks. The reason is that although presubscription is significant for the residential and small customers, the larger customers that generate most long distance revenues (and who RBOCs are seeking to serve) make extensive use of WATS and private line services which are unaffected by presubscription. And presubscription will not eliminate disputes over whether the local bottlenecks have been leveraged to compete unfairly in serving even smaller customers, for it is the RBOCs that administer the customer selection process.

The Department has further urged that the RBOCs be allowed to provide interexchange services between points "outside" their regions today, whether or not they have local monopolies in their regions. This contention ignores that the Decree Court rejected this alternative when the Decree was entered. The fact is that interexchange services is a single national market; that the RBOCs local exchanges can be leveraged (or used to cross-subsidize) extraregional interexchange services; and that the District Court has found that to allow RBOCs to participate in any aspect of the national interexchange market would place them on a "slippery slope" in which greater and greater incursions would occur despite the RBOCs' control over bottleneck monopolies. United States v. Western Electric Co., 627 F. Supp. 1090, 1097 n.25 (D.D.C. 1986).

The only explanation for the Department's position, therefore, is that it has abandoned the antitrust theory of the Decree: the bottleneck leveraging doctrine. Indeed, the Department's Report makes it explicit that it has done precisely that. For example, in recommending removal of the manufacturing prohibition, the Department candidly states its expectation that RBOCs will procure most or all their equipment from their affiliates, regardless of price or quality, and thus foreclose to unaffiliated manufacturers the 10-20 percent of the American market that each one of seven RBOCs represents. Department's Report, pp. 169-70. This is precisely the leveraging of local bottlenecks into equipment markets that the Department previously contended, and the District Court previously held, violates Section 2 of the Sherman Act. United States v. AT&T, 524 F. Supp. 1336, 1379 & n.174 (D.D.C. 1981). The purpose of the Decree was to establish "prophylactic measures" to prevent any possibility of such leveraging by the seven RBOCs, not to encourage it. United States v. Western Electric Co., 592 F. Supp. 846, 869 (D.D.C. 1984).

In a similar vein, the Department acknowledges that manufacturing relief would regenerate all the controversies over whether the RBOCs purchased affiliates' equipment at inflated prices, misallocated manufacturing costs to captive ratepayers, and otherwise cross-subsidized manufacturing operations so as to evade rate regulation. Department's Report, pp. 169-70, 174-75. In stark contrast to its prior positions (see pp. 9-10, supra), the Department's Report states (p. 166) that such RBOC conduct and the adverse effects on ratepayers and consumers do not present antitrust concerns, despite the fact that the antitrust laws are, above all else, designed to protect consumers. Associated General Contractors v. Carpenters, 459 U.S. 519, 538 (1983); Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979).

The Department's Report similarly states that an RBOCs use of captive ratepayers to cross-subsidize manufacturing operations is not a "competitive concern" because AT&T and other manufacturers allegedly have the ability to "respond in kind." Department's Report, 189, 199 n.412, 205 n.434. Quite apart from the fact that Judge Greene has explicitly found that the post-divestiture AT&T cannot engage in this cross-subsidization (United States v. AT&T, 552 F. Supp. 131, 170-74 (D.D.C. 1982)), the objective of the antitrust laws and the Decree is to prevent cross-subsidies, not encourage them.

In this regard, there is one problem that exists under the Decree today: it is not being adequately enforced by the Department. There are several examples of the Department's inability to investigate reported violations and enforce the Decree in a timely manner. One of the starkest is the Department's conceded refusal to enforce the manufacturing prohibition over the past two years -- on the untenable ground that the line between permissible exchange functions and prohibited manufacturing functions might be difficult to enforce. Department's Report, p. 168 n.330. There are other examples,[11] and the problem can be expected to worsen. The Antitrust Division has proposed cutting an additional 100 positions in its 1988 budget. Telecommunications Reports,

p. 23 (March 2, 1987). AT&T has sought to address these enforcement problems by asking the Decree Court to further modify the "catchall" injunction that is the source of great burdens on the Department.

2. The Post-Divestiture Experience And Controversies Demonstrate The Continuing Need For The Decree

The proposals to eliminate the Decree are ironic because the experience in three years since divestiture has demonstrated that this Antitrust Decree not only prevents recurrence, on a massive scale, of the debilitating controversies that led to the Decree, but also provides clear rules and swift and certain remedies in the Decree Court in those instances in which RBOCs nevertheless attempt to foreclose competition in the markets that the Decree protects.

First, despite the existence of the Decree, there have been occasions in which RBOCs have attempted to leverage their local bottleneck monopolies to foreclose competition by interexchange carriers.

For example, in February, 1984, Pacific Telesis flatly refused to provide the essential local facilities that AT&T needed to provide an interexchange public telephone service (in California Airports) that would compete with Pacific's coin and coinless telephones. See United States v. Western Electric Co., 583 F. Supp. 1257 (D.D.C. 1984). Similarly, in 1985 and 1986, U S West sought to replace the interexchange switching service that AT&T provides to the United States Government by offering special low rates for bottleneck access facilities if and only if GSA agreed to obtain these services from U S West. Opinion, United States v. Western Electric (November 26, 1986). In each instance, the RBOCs' conduct constituted a classic example of leveraging a bottleneck monopoly.

However, AT&T was not required to file separate antitrust suits and incur the associated expense and delays of discovery and proving damages. In each case, the Decree provided a swift and certain remedy. AT&T filed complaints with the Decree Court, which in each instance proceeded to enjoin the RBOCs' conduct within a matter of weeks. Both examples, moreover, thoroughly refute the suggestions (see pp. 33, supra) that state or federal regulation can prevent these abuses. In each, the RBOC justified its anticompetitive conduct by claiming that it was required by state regulation (Pacific Coinless Telephone Service, 583 F. Supp. at 1259-60) or by the interplay of federal and state regulations (Opinion, pp. 5-6 (Nov. 26, 1986)). Under the Decree, both claims were readily dismissed. Id.; see also 583 F. Supp. at 1259-60.

The disputes that have resulted in injunctions against RBOCs are merely the tip of the iceberg. Elsewhere, the existence of the Decree has meant that RBOCs did not even attempt to provide interexchange services or engage in manufacturing because the District Court held that their proposals presented unacceptable competitive risks under the Decree. See Opinion, United States v. Western Electric Co. (Dec. 29, 1986) (manufacturing); id., 627 F. Supp. 1090, 1098-1104 (D.D.C. 1986) (interexchange shared tenant services); id., 592 F. Supp. 846, 867-868 (D.D.C. 1984) (interexchange private network for NASA). In still others, when RBOCs have gone ahead and engaged in what may be impermissible activities, interexchange competitors and manufacturers have filed complaints with the Decree Court.

If the Decree were modified, the swift remedies would disappear. RBOCs would be absolutely free to enter interexchange and manufacturing markets in competition not only with the Bell System's predivestiture competitors, but also with the post-divestiture AT&T and the many firms that have entered these markets since divestiture. When confronted with suspected anticompetitive leveraging, these competitors would again be remitted to filing suits, episode-by-episode, in district courts throughout the country and recreating the very burdens on the industry, and the federal courts, that the Decree sought to end. Because there are seven RBOCs (as opposed to one Bell System) and hundreds of new participants that are not affiliated with RBOCs (including AT&T), the potential for disputes is many times greater than it was prior to divestiture.

The extent of the potential antitrust problem is further demonstrated by the controversies that have arisen over whether RBOCs have leveraged their local monopolies to foreclose competition in the markets that were not at issue in United States v. AT&T and that the Decree permits the RBOCs to serve.[12] The point is not that the RBOCs are guilty of wrongdoing. Rather, it is that these charges demonstrate that the debilitating controversies that the Decree sought to end would be inevitable if the RBOCs were permitted to reenter the Decree's core competitive markets.

3. Removal Of Injunctions Would Subvert Other Vital National Interests

Finally, the proposals to eliminate the Decree's line of business injunctions ignore that these provisions do more than promote competition. They are "interrelated components of a plan to reorganize the Bell System and hence -- in effect -- the nation's telecommunications industry" in ways that would not only foster competition, but also such vital national interests as promoting foreign trade, preventing balkanization of the national telephone network, preserving reliable, high quality service, and fostering universal service. See United States v. Western Electric Co., 592 F. Supp. 846, 860, 874 (D.D.C. 1984); id., 569 F. Supp. 990, 1000 n.49 (D.D.C. 1983); id., at 1057, 1120 (D.D.C. 1983), pp. 24-25, supra. Removal of the injunctions would subvert these goals.

The Decree was carefully fashioned, for example, to assure that AT&T, America's leading full-line telecommunications equipment manufacturer would not be foreclosed from any portion of the American market and thus be "preserved" as a "dynamic force" capable of competing in national and international markets. See p. 24-25, supra. Removal of the injunctions, in contrast, would create a market structure in which some or most RBOCs could be expected to form joint ventures with other central office switch manufacturers (virtually all of whom are foreign firms) and, by the Department's admission, foreclose the only free market in the world to AT&T. Department's Report, pp. 173-76. This development would be an especially clear interference with free trade because Japanese and European manufacturers have, to date, successfully excluded AT&T from Japan and German, French and other European markets; they now seek to form joint ventures with RBOCs to exclude AT&T from American markets as well.

In short, the foreign trade consequences of lifting the injunctions could be devastating. Such a move would simultaneously (1) foreclose American markets to American firms, (2) deny American firms the revenues needed to sustain the R&D needed to sell equipment in Asian, Middle Eastern and other foreign markets, and (3) give foreign firms captive markets and guaranteed sales in this country. It is for these reasons that the Department of Commerce found in its filing to the Decree Court that the Department's manufacturing recommendation could well damage foreign trade. See NTIA Trade Report, p. iv.

Second, removal of the injunctions would threaten the high quality and reliable telephone service that is critical to the nation's businesses, residences, and defense. For example, the Department recognizes (Department's Report, pp. 178) that it would require severe curtailment of the RBOCs' centralized engineering activities that the Decree

Court found essential to prevent the "balkanization," "deterioration and fragmentation of the national telephone system." United States v. Western Electric Co., 569 F. Supp. at 1118. Further, the District Court has found that making the RBOCs direct competitors of interexchange carriers would threaten consumers with further "provisioning crises" that prevent timely and reliable service. United States v. Western Electric Co., 592 F. Supp. at 863.

And removal of the injunctions would threaten universal service and ratepayer interests. As the Decree court has held, again and again, the injunctions are designed to prevent cross-subsidization that inflates local rates. E.g., United States v. Western Electric Co., 592 F. Supp. at 853-855.

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For these reasons, AT&T is opposed to any proposals to eliminate or modify the Decree's core line of business injunctions at this time. We believe that legislative activity would be especially inappropriate because the antitrust issues are subject to ongoing review in the Federal courts. Indeed, such proceedings are pending in the Decree Court today.

I thank the Committee for its invitation. I would be pleased to respond to any questions.

FOOTNOTES

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1. See Otter Tail Power Co. v. United States, 410 U.S. 366, 377 (1973); Northern Pacific Railway v. United States, 356 U.S. 1, 11 (1958); Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 608-609 (1953); United States v. Griffith, 334 U.S. 100, 107 (1948); Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 275-76 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980); Sargent-Welch Scientific Co. v. Ventron Corp., 567 F.2d 701, 709, 711-713 (7th Cir. 1977), cert. denied, 439 U.S. 822 (1978).

2. The Department analogized the BOCs' local exchanges to such "essential facilities" as the stadium in Hecht v. Pro-Football, Inc., 570 F.2d 982 (D.C. Cir. 1977), cert. denied, 436 U.S. 956 (1978); the warehouse in Gamco, Inc. v. Providence Fruit & Produce Bldg., Inc., 194 F.2d 484 (1st Cir.), cert. denied, 344 U.S. 817 (1952); the railroad terminal in United States v. Terminal R.R. Ass'n of St. Louis, 224 U.S. 383 (1912); the pipeline in Woods Exploration & Producing Co. v. Aluminum Co. of America, 438 F.2d 1286 (5th Cir. 1971), cert. denied, 404 U.S. 1047 (1972); and the power transmission facilities in Otter Tail Power Co. v. United States, 410 U.S. 366 (1973). See August 16, 1981, DOJ Memorandum, pp. 39, 76; United States v. AT&T, 524 F. Supp. at 1352-53.

3. See, e.g., Southern Pacific Communication Co. v. AT&T, 556 F. Supp. 825 (D.D.C. 1982) (as amended January 10, 1983), aff'd, 740 F.2d 980 (D.C. Cir. 1984), cert. denied, 470 U.S. 1005 (1985); MCI Communications Corp. v. AT&T, 708 F.2d 1081 (7th Cir.), cert. denied, 464 U.S. 891 (1983); Data Transmission Corp. v. AT&T, No. 76-1544 (D.D.C.); MCI Communications Corp. v. AT&T, No. 79-1182 (D.D.C.); Southern Pacific Communications Corp. v. AT&T, No. 83-0094 & MDL 550 (N.D. Cal.); United States Transmission Systems v. AT&T, No. 82 Civ. 1986 (S.D.N.Y.).

4. See, e.g., International Telephone and Telegraph Corp. v. AT&T, No. 77 Civ. 2854 (S.D.N.Y.); Conrac Corp. v. AT&T, No. 82 Civ. 2330 (S.D.N.Y.); Telesciences v. AT&T, No. 80-2445 (D.D.C.); General Dynamics Corp. v. AT&T, No. 82-C-7941 (N.D. Ill.); Glictronix Corp. v. AT&T, No. 82-4447 (D.N.J.); Gregg Communication Systems v. AT&T, No. 82-C-6291 (N.D. Ill.); Jack Faucett Assoc., Inc. v. AT&T, No. 81-1804 (D.D.C.) (and four consolidated cases); KWF Industries, Inc. v. AT&T, No. 83-0431 (D.D.C.); Phonetele, Inc. v. AT&T, No. 74-3566-FW (C.D. Cal.); Rice International Corp. v. AT&T, No. 82-2573 (S.D. Fla.); Selectron, Inc. v. Pacific Northwest Bell Telephone Co., et al., No. 76-965-BE (D. Ore.); Sound, Inc. v. AT&T No. 76-182-2 (S.D. Iowa) (and one consolidated case); DASA Corp. v. AT&T, No. 83-2695 (E.D. Pa.); Amtel Communications, Inc. v. AT&T, No. 82-8754 (S.D.N.Y.); Telephonic Equipment Corp. v. AT&T, No. 82-C-8478 (S.D.N.Y.).

5. See, e.g., United States v. AT&T, 524 F. Supp. at 1345, 1357-60; United States v. AT&T, 427 F. Supp. 57, 61 (D.D.C. 1976), cert. denied, No. 77-1009 (D.C. Cir.), cert. denied, 434 U.S. 966 (1977); United States v. AT&T, 461 F. Supp. 1314, 1320-30 (D.D.C. 1978). See also Southern Pacific Communications Co. v. AT&T, 740 F.2d 980, 999-1000 (D.C. Cir. 1984), cert. denied, 470 U.S. 1005 (1985) (and cases cited).

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6. *See*, *e.g.*, *Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, 77 F.C.C.2d 384 (1980), *aff'd sub nom. Computer & Communications Industry Association* v. *FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983); FCC CC Docket No. 78-72 (exchange access); FCC CC Docket No. 80-742 (license contracts); FCC CC Docket No. 80-53 and No. 19129 (Phase II) (Bell System procurement practices); *AT&T, Manual and Procedures for the Allocation of Costs*, 84 F.C.C.2d 384, *modified*, 86 F.C.C.2d 667 (1981), *aff'd sub nom. MCI Telecommunications Corp.* v. *FCC*, 675 F.2d 408 (D.C. Cir. 1982); H.R. 12323, 94th Cong., 2d Sess. (1976); H.R. 13015, 95th Cong., 2d Sess. (1978); H.R. 3333, 96th Cong., 1st Sess. (1979); S. 611, 96th Cong., 1st Sess. (1979); S. 622, 96th Cong., 1st Sess. (1979); H.R. 6121, 96th Cong., 1st Sess. (1979); S. 2827, 96th Cong., 2d Sess. (1980); S. 898, 97th Cong., 1st Sess. (1981); H.R. 5158, 97th Cong., 1st Sess. (1981); *MCI Communications Corp.* v. *AT&T*, No. 74C 633, Complaint, Prayer for Relief, ¶¶ 4-6 (N.D. Ill. March 6, 1974); *MCI Communications Corp.* v. *AT&T*, No. 79-1182, Complaint for Violations of the Antitrust Laws, Prayer for Relief, ¶¶ 6-8 (D.D.C. April 30, 1979).

7. *United States* v. *AT&T*, No. 74-1698, Tr. 25179; *id.*, Brief of United States, p. *30* (June 14, 1982).

8. Testimony of Douglas H. Ginsburg concerning S. 2565, The Federal Telecommunications Policy Act of 1986, Before Senate Committee on Commerce, Science and Transportation, p. 4 (September 10, 1986).

9. U.S. Dept. of Commerce, NTIA Trade Report: Assessing The Effects Of Changing The AT&T Consent Decree, p. 47 (February 4, 1987) (hereinafter cited as NTIA Trade Report).

10. J. Michel Guite, Ph.D., Salomon Brothers, Stock Research on Telecommunications Equipment, The United States Market, p. 11 (February 1987).

11. For example, on March 12, 1987, MCI had to request the District Court to enter an order to force Bellcore, BellSouth Corp. and Southwestern Bell Corp. to stop developing the 800 service database that directly competes with interexchange services. This request repeats an issue that AT&T first raised with the Department nearly two years ago in May 1985 (*see* Letter from Francine J. Berry to Kevin R. Sullivan, dated May 28, 1985) -- and on which the Department never acted.

Similarly, even after the Decree Court entered an order on November 26, 1986, that held that U S West had unlawfully discriminated and foreclosed competition on the FTS network or other private networks, the Department still has not taken any action on AT&T's May 15, 1986 request to enforce the Decree with respect to U S West's use of discriminatory pricing to replace four AT&T switches on the FTS Network in late 1985 and early 1986.

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12. Even today, for example, RBOCs have been charged by their customers and competitors alike with (1) pricing access facilities without regard to cost, at excessive levels, and discriminatorily to pursue strategic RBOC interests (Comments of International Communications Association, United States v. Western Electric, No. 82-0192, p. 8 (March 13, 1987)); (2) refusing to provide exchange access facilities that RBOCs are technologically able to provide, even in the face of explicit FCC orders (Comments of National Association of State Utility Consumer Advocates, United States v. Western Electric, No. 82-0192, pp. 31-32 (March 13, 1987)); (3) denying equal access to local toll competitors and diverting their calls to RBOC facilities (id., p. 30); (4) engaging in what has been found by a NARUC subcommittee to be widespread cross-subsidization of unregulated businesses with regulated revenues and then impeding regulatory efforts to uncover it (Comments of Public Service Commission of the District of Columbia, United States v. Western Electric, No. 82-0192, pp. 29-33 (March 13, 1987)); (5) negotiating in bad faith over access to RBOC conduits (for four years in one instance) and then charging "exorbitant rates" for use of the facilities that far exceed the cost of the RBOC (U.S. Dept. of Commerce, NTIA Report on Competition in the Local Exchange Telephone Service Market, p. 46 (February 1987)); (6) negotiating with cellular competitors in bad faith over interconnections, squeezing net revenues of cellular competitors by charging excessive rates for essential RBOC facilities (which are simply internal transfer prices for the RBOC), and otherwise restricting cellular carrier services (Comments of Cellular Telecommunications Division of Telocator Network of America, United States v. Western Electric, No. 82-0192, pp. 8-9 (March 13, 1987)); (7) denying competitors' requests for information about customers and interfering in relationships between these firms and their customers (Comments of Dun & Bradstreet Corp., United States v. Western Electric, No. 82-0192, pp. 34-37 (March 13, 1987)); (8) refusing to interconnect with competing local carriers and to divide revenues with them (Comments of Teleport Communications, United States v. Western Electric, No. 82-0192, pp. 5-13 (March 13, 1987)); and (9) using monopoly revenues to cross-subsidize RBOC Centrex offerings (Comments of National Association of State Utility Consumers Advocates, United States v. Western Electric, No. 82-0192, pp. 9-10 (March 13, 1987)).

Senator METZENBAUM. Thank you very much, Mr. Zeglis.

Our next witness is Bert Roberts, President of MCI.

Mr. ROBERTS. Thank you, Mr. Chairman.

Mr. Chairman, your leadership in calling this hearing is to be commended. In MCI's view, the Modified Final Judgment entered in the AT&T antitrust case remains as valid today as it was three years ago. Nothing has changed which warrants stripping away the antitrust protections so critical to the continued evolution of a vigorously competitive telecommunications marketplace.

No one would disagree that the divestiture of AT&T entailed risk and almost epic changes in our industry. But that risk, and a difficult adjustment to change, are now being rewarded with increasing competition and benefits to consumers in the form of expanded choice in innovative services and equipment, and a reduction of over 30 percent in long distance rates.

Unfortunately, we are threatened today with a return to the predivestiture environment. Without a grain of substantiation, the Justice Department in its February report to the Antitrust Court reversed the antitrust enforcement policy pursued by Republican and Democratic administrations since the early Seventies.

On Monday, the Justice Department again flip-flopped by asking the court to retain the decree's restrictions against BOC's providing long distance service. Even with this change of position, which MCI welcomes, we remain concerned about the continued public statements of the Acting Assistant Attorney General Rule and others since last year that the MFJ should be altered to let the BOC's into the long distance market.

Clearly, in our view, Justice's other recommendations on information services and manufacturing remain fatally flawed. MCI is most dismayed by Justice's continued reliance upon the ability of the FCC to prevent anti-competitive abuse and Justice's transparent attempt to rewrite history as to the dangers of those competitive abuses. This industry has endured a long history of failed regulation, culminating in the Government's lawsuit against the Bell System. Yet, the regulatory schemes upon which the Department of Justice relies, involve the same regulatory principles that failed to prevent cross-subsidization and discrimination in the past.

Mr. Chairman, let's look at what has happened since divestiture. With the MFJ and its separation of the local exchange monopoly from the potentially competitive activities of the Bell System, the incentives for entrepreneurial investment in the telecommunications industry have improved dramatically.

MCI and others have responded to this new competitive opportunity by making substantial investments to ensure the vitality of that competition. Mr. Chairman, removing the protections of the MFJ would not only endanger the benefits competition has brought but moreover, encourage the abuses of the marketplace of the 1970s.

Experience has shown that a monopoly provider of services has the ability and the incentive to abuse its bottleneck control to the detriment of competitive providers of telecommunication services and products.

In fact, this Committee, the Justice Department, and the FCC should not be asking whether the terms of the decree should be changed. Instead, we should all be asking why local rates charged by the Regional Bell Operating Companies have gone up nearly 40 percent since divestiture, while those companies have each reported annual earnings in excess of $1 billion.

We should be asking why the FCC has allowed monopoly service providers guaranteed interstate rates of return since divestiture of over 12 percent, five percentage points higher than the current market interest rates.

We should be concerned with monopoly ratepayers being forced to finance diversification by the Regional Bell Holding Companies into computer sales, financial services, insurance, real estate, and foreign investment ventures.

We should be asking who will finance the Bell Operating Companies' stated desires to enter the long distance information services and manufacturing markets. The answer, of course, will be local ratepayers and interexchange carriers like MCI, Sprint and AT&T who purchase access to get into the local exchange market.

We are not asking Congress, the courts or the FCC to keep large financially viable companies out of the market. We would not oppose fair competition from the Regional Bell Holding Companies. But for that competition to be fair, there has to be either an end to the monopoly bottleneck at the local exchange, or a divestiture of the local operating companies by the RBOCs.

We are confident, Mr. Chairman, that after today's hearing and others, that we hope will follow, you will agree that the antitrust principles underlying the Modified Final Judgment embody a public policy objective which we all must fight to reserve for the ratepayers, for competition, and for the national interest.

Thank you.

[Statement follows:]

STATEMENT OF

BERT C. ROBERTS, JR.

PRESIDENT

MCI COMMUNICATIONS CORPORATION

Mr. Chairman, your leadership in calling this hearing is to be commended. In MCI's view, the Modified Final Judgement entered in the AT&T antitrust case remains as valid today as it was three years ago. Nothing has changed which warrants stripping away the antitrust protections so critical to the continued evolution of a vigorously competitive telecommunications marketplace.

The separation of the competitive and monopoly businesses of the old Bell System was designed to create an industry structure in which interexchange, information services and telecommunications equipment competition could flourish. Pre-divestiture, monopoly abuses of the integrated Bell System stifled competition, hobbled the introduction of new technology and thwarted the effectiveness of both state and FCC regulation.

No one would disagree that the divestiture of AT&T entailed risk and almost epic changes in our industry. But that risk, and a difficult adjustment to change, are now being rewarded with increasing competition and benefits to consumers in the form of expanded choice in innovative services and equipment and a reduction of over 30% in long distance rates.

Unfortunately, we are threatened today with a return to the pre-divestiture static environment. Without a grain of substantiation, the Department of Justice in its February report to the Antitrust Court reversed antitrust enforcement policy pursued by Republican and Democratic Administrations since the early '70's.

MCI's alarm at the evaporation of support for the MFJ by the Department of Justice was intensified given that the underlying factual predicate of the MFJ, the existence and potential for abuses of the local monopoly bottleneck, have not changed at all. To the contrary, Justice's February recommendation acknowledged the local exchange bottleneck; but incomprehensibly went on to endorse a totally contradictory policy.

On Monday, the Justice Department again flip-flopped by asking the court to retain the decree's restrictions against the BOC provision of long distance service. Even with this change of position, which MCI welcomes, we remain concerned by the continued public statements of Acting Assistant Attorney General Rule and others since last year that the MFJ should be altered to let the BOCs into the long distance market.

Clearly, in our view, Justice's other recommendations on information services and manufacturing remain fatally flawed. MCI is most dismayed by Justice's continued reliance upon the ability of the FCC to prevent anticompetitive abuse and Justice's transparent attempt to rewrite history as to the dangers of those competitive abuses. This industry has endured a long history of failed regulation, culminating in the government's lawsuit against the Bell System. Yet the regulatory schemes, upon which the Department of Justice relies, involve the same regulatory principles that failed to prevent cross-subsidy and discrimination in the past.

Mr. Chairman, let's look at what has happened since divestiture. With the MFJ - and its separation of the local exchange monopoly from the potentially competitive activities of the Bell System - the incentives for entrepreneurial investment in the telecommunications industry have improved dramatically.

MCI and others responded to this new competitive opportunity by making substantial investments to ensure the vitality of that competition. In reliance on the government's stated policy of separating competitive from monopoly markets, MCI has invested at the rate of almost one billion dollars per year to construct the most modern and diversified fiber optic and digital long distance network in the country.

Since divestiture, MCI, the company that pioneered long distance competition, has doubled its market share and grown to be the 199th largest corporation in the country, with annual revenues approaching $4 billion. In the international market, MCI offers voice service to over 50 countries and provides data and telex services to more than 200 nations.

The experience of MCI is not unique. Mr. Chairman, competition is emerging as a strong and vital force in telecommunications. The American teleommunications consumer is enjoying a wider choice of new and innovative services and equipment at lower rates. And all this is occurring in spite of the policies of the recently departed FCC Chairman who had been consistently pro-monopoly and anti-antitrust.

Mr. Chairman, removing the protections of the MFJ would only endanger the benefits competition has brought and encourage the abuses of the marketplace of the 1970's. Experience has shown that a monopoly provider of services has the ability and incentive to abuse its bottleneck control to the detriment of competitive providers of telecommunications products and services.

In fact, this Committee, the Justice Department, and the FCC should not be asking whether the terms of the decree should be changed. Instead, we should all be asking why local rates charged by the Regional Bell Operating Companies have gone up nearly 40 percent since divestiture, while those companies have each reported annual earnings in excess of $1 billion.

We should be asking why the FCC has allowed monopoly service providers guaranteed interstate rates of return since divestiture of over 12 percent - 5 percentage points higher than current market interest rates.

We should be concerned with monopoly rate payers being forced to finance diversification by the Regional Bell Holding Companies into computer sales, financial services, insurance, real estate, and foreign business ventures.

We should be asking: Who will finance the Bell Operating Companies' stated desires to enter the long distance, information services and manufacturing markets? The answer will be the local rate payers and the interexchange carriers like MCI, Sprint, and AT&T who purchase access to get into the local exchange network.

We are not asking the Congress, the Courts or the FCC to keep large, financially viable companies out of our market. We would not oppose fair competition from the Regional Bell Holding Companies. But for that competition to be fair, there has to be either an end to the monopoly bottleneck at the local exchange, or a divestiture of the local operating companies by the RBOCs.

We are confident that after today's hearing, and others we hope will follow, you will agree that the antitrust principles underlying the MFJ embody a public policy objective which we all must fight to preserve - for ratepayers, for competition, for the national interest in an information age.

Senator **Metzenbaum**. Thank you, Mr. Roberts.

Mr. Roberts, how is Mr. McGowan doing?

Mr. **Roberts**. He had surgery, you know. He is recovering and, as I understand it, doing well in his recovery.

Senator **Metzenbaum**. Thank you.

Mr. Kimmelman.

Mr. **Kimmelman**. Thank you, Mr. Chairman.

Mr. Chairman, members of the Subcommittee, on behalf of the Consumer Federation of America, I appreciate this opportunity to bring you our concerns about the Department of Justice's recommendations to Judge Greene.

As you have already heard this morning from the Department, we have seen a major shift in policy of this Administration between the time of the breakup and its current recommendations to Judge Greene.

Mr. Rule claims this is not an issue of telephone rates, it is not an issue of universal telephone service. But this is a major departure from the arguments the Department of Justice made a number of years ago to the American public and to the court when it proposed a settlement of the case and agreed with the Consent Decree to break up AT&T.

Something has changed, and we believe it is the political position at the Department. Now the Department relies on a regulatory environment that we believe has not served consumers well and shows no signs of improvement.

Now, just a review of recent developments in telephone rates will give you some idea of why we oppose the Department's recommendations.

Since the divestiture, we have seen a revolution in telephone pricing in this country. All the equipment of the telephone network that connects local, long distance, computer services, everything—for each of these services, used to pick up part of the cost of that network. The costs have now been shifted over to local rates.

First, we got access charges that consumers all around the country have to pay, $2 now, going up to $3.50, charges that used to be in long distance bills. Because of this and local rate cases, we see a rise in local charges of about 40 percent, four times the inflation rate, since the divestiture of AT&T.

Now, long distance rates have come down, but not all. In-State long distance is up 4 percent. Interstate long distance is down somewhere between 20 and 40 percent depending on what time of day you call. Incidently, for the times consumers make their calls, it is the smaller percentage of decrease. And this has been mainly because of regulatory decisions, not because of competition in the market.

Overall, because consumers do very little long distance calling, but rely on the phone basically for local service, the Bureau of Labor Statistics tells us that rates are up overall almost 20 percent since the divestiture.

Just imagine if the Department came before you today, or came before the court to recommend a breakup of the Bell System for the facts I have just described to you, how would you or possibly Judge Greene react given the following circumstances? We've got the lowest inflation rate in this country in 20 years. We have very low interest rates in the marketplace. We have Bell Companies earning between 2½ and 3½ percentage points greater return on equity than even the most competitive companies in this country or other utilities. And they are bringing in over $3 billion from ratepayers, businesses, consumers on an annual basis that are excessive.

Now, the FCC rules that the Department relies upon, they are continuing this trend of shifting network costs to local rates. And, finally, the State regulatory environment that the Department relies upon to protect the public against rate increases is being challenged, challenged by the very companies that support the Department's recommendations to lift the restrictions.

Under these circumstances, does it make sense to change the rules of the game? Does it make sense to trust regulatory rules and allow for these significant local rate increases? We believe that the Department was wrong to recommend these changes now, and we have urged Judge Greene to leave things alone for awhile. We believe the American public has had enough confusion in telephones over the last few years. It is time for some settling down.

And, furthermore, we believe that if there are changes to be made, they should be made by the Congress, not by the Department of Justice, not by the courts. They should be made by the Congress making sure that universal service is put in the forefront, universal service, the affordable phone service the American people really want and the Department evidently does not believe it should be concerned about.

Thank you, Mr. Chairman.

[Statement follows:]

Consumer Federation of America

Statement

of

Gene Kimmelman*

Legislative Director

Consumer Federation of America

Before the

Antitrust, Monopolis and Business Rights Subcommittee

of the

Senate Judiciary Committee

on

The Department of Justice Report and Recommendations Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies By the Modification of Final Judgement

April 30, 1987

* Special thanks to David Nall, Staff Attorney, Citizens Communications Center of Georgetown University Law Center

SUMMARY

The Consumer Federation of America (CFA) is deeply concerned over the impact elimination of the Modified Final Judgment's (MFJ) line-of-business restrictions would have on consumers' local phone bills and choice of telecommunications services. CFA believes that elimination of the line-of-business restrictions is not justified under the specific terms of the consent decree, because there remains a substantial possibility that the Bell Operating Companies (BOCs) would be able to use their monopoly power to impede competition if they entered restricted markets. As a result, lifting the restrictions would undermine the underlying public interest goals of preserving and furthering universal, affordable telephone service.

CFA thus opposes the Department of Justice's (DOJ) recommendation to lift nearly all of the restrictions. This recommendation is unsupported by evidence of market place changes in the telecommunications industry since divestiture, fails to consider important changes in the state and federal regulatory environment, and is reflective of nothing more than the changing political perspective of the Department of Justice.

The MFJ restrictions represent a significant dam holding back of reservoir of monopoly power within the local telephone exchange, but the DOJ now recommends destruction of this protective barrier. Rather than pursue the antitrust goals and factual analysis embraced in the terms of the consent decree, the DOJ has changed course: it now offers a plan of action which is substantially at variance with the antitrust policies upon which it based its case against AT&T and with the consent decree which that case generated.

Rather than subject the American public to the risk inherent in restructuring the industry based on an uncertain regulatory environment and skewed economic analysis, CFA believes policymakers should maintain the protection that current restictions provide against cross-subsidy. Further inclusion of the Federal Communications Commission (FCC) in issues related to the restrictions may spur the agency, and the Regional Bell Holding Companies (RHCs), to devise a network structure that minimizes the likelihood of cross-subsidy, and cost allocation rules that do not threaten the goal of universal service, unlike the pricing theories of the FCC, DOJ and DOJ's consultant, Peter Huber. CFA is hopeful that, through maintenance of the decree's current restrictions, the RHCs will develop concrete mechanisms that promote universal service and protect competition in the dynamic federal and state regulatory environments which they strongly influence.

I. INTRODUCTION

As local telephone rates keep climbing, consumers wonder what happened to the promises of the information age. Efforts to integrate new, exotic services into the local telephone network appear to carry a hefty price tag: the risk of continued local rate increases and reduced competition.

CFA believes that ratepayers' pocketbooks must be protected and the benefits of competition made available to all consumers before the BOCs are released from the restrictions they voluntarily agreed to as part of the Bell system breakup. Consumers have already been asked to bear more than their fair share of post-divestiture risks. Any further telecommunications policy changes must, first and foremost, promote attainment of affordable phone service for all Americans.

II. BACKGROUND

As telecommunications technology changes and public reliance on the telephone increases, consumers face new challenges to their desire to preserve affordable phone service. After almost twenty years of watching the federal and state governments struggle to protect affordable service while increasing competition, consumers remain unconvinced that policymakers know how to open the door to the information age without shutting the door on cheap, high quality basic phone service.

A. Technology and Regulation

Policymakers have fought an uphill battle, using everything from rate-of-return regulation to divestiture, in an effort to keep the price of monopoly services -- like local residential service -- down while opening the equipment, long distance and computer markets to full, fair competition. Unfortunately, the tools of public policy have not developed at the same pace as technology.

Technology has eroded many of the conceptual distinctions essential to effective regulation. For example, regulatory policies based on a clear distinction between communications and computer technologies became ineffective as telephone companies began using computerized equipment. Similarly, technical changes in equipment and service have outpaced accounting definitions and categories, making it impossible for the FCC to establish a uniform accounting system that properly allocates costs.

B. Market Segmentation/Competition

These regulatory difficulties have been exacerbated by the uneven development of competition in niche markets surrounding the local network monopoly. Since the network of lines and switches connects both monopoly (e.g., local residential service) and competitive (e.g., long distance and data processing) services, regulators must divide network costs among these services. As competition develops for a particular product, like telephones, or service need, like big-business data communications, regulators must restructure prices. Yet without effective accounting tools or a head-start on technology, it is difficult, if not impossible, for regulators to divide the $30-40 billion of today's shared network costs without impeding competition or driving up basic service prices.

C. Dangers of Lifting Bell Operating Company Restrictions

Because a misallocation of network costs can mean the difference between affordable local phone service and doubling or tripling local rates, CFA is fearful, under current regulatory conditions, of letting the companies that control the local network -- the BOCs -- enter competitive markets. Until policymakers develop the regulatory tools necessary to catch up with technology, and properly allocate the cost of jointly used equipment and resources, consumers have more to lose than gain from local phone company diversification into competitive markets.

III. TELEPHONE INDUSTRY DEFIES THE MARKET

A. Local Rates

Despite market conditions that point clearly in the direction of lower telephone rates -- both local and long distance, the average consumer's phone bill has risen about 20 percent since the breakup of AT&T. [1] Even though our nation is experiencing the lowest inflation rate in over 20 years, consumers have faced a 40 percent increase in local phone charges since divestiture, driving local rates from an average of $10.55/month in 1983 to about $15.40/month at the beginning of 1987. [2]

B. Bell Company Earnings

While the profit rates of all other utilities and the nation's most competitive firms fell significantly as post-divestiture inflation and the cost of money have declined, the RHCs' earnings have soared. By earning a 2.5-3.5 percentage point greater return on equity than all other utilities and the Business Week Top 1000 (see Table 1), and through excessive depreciation expenses and shifts in capital structure, the RHCs have been charging ratepayers about $3 billion per year too much for the last two years. [3] Had the RHCs been allowed to earn a rate of return no greater than the nation's other largest corporations, telephone rates would have increased no more than the 9 percent general inflation rate since the Bell breakup. [4]

C. Inadequate Regulatory Response

Recognizing this unjustified discrepancy between regulated phone companies' earnings and the rest of the market, the Federal Communications Commission (FCC) reduced AT&T's and the RHCs' interstate rate of return last fall. [5] By dropping AT&T's rate of return from 12.75 to 12.2 percent and the RHCs' from 12.75 to 12.0 percent, the FCC provided consumers welcome relief: long distance rate reductions that are not tied to local rate increases. Unfortunately, the Commission stopped short of reducing profit rates as much as current market conditions warrant, and most states have done nothing at all to reduce intrastate rates of return.

TABLE 1:

RETURN ON EQUITY AND DIVIDEND YIELD:
RHCS COMPARED TO ALL LARGE CORPORATIONS AND OTHER UTILITIES

	RETURN ON EQUITY (IN PERCENT)			DIVIDEND YIELD (PERCENT OF MKT PRICE)		
	1984	1985	1986	1984	1985	1986
AMERITECH	14.1	14.5	15.0	7.3	5.5	5.4
BELL STL.	13.1	13.8	14.2	7.7	5.5	5.4
BELL SOU.	13.4	14.2	14.4	7.4	5.4	5.2
NYNEX	12.9	13.3	13.9	7.6	5.5	5.4
PACTEL	12.8	12.8	14.1	7.1	6.4	5.7
SW BELL	12.9	13.6	13.4	7.2	6.6	6.0
US WEST	13.3	13.3	12.7	7.6	5.9	5.4
RHC AVG.	13.2	13.7	14.0	N/A	N/A	N/A
NON-RHC UTILITIES	9.8	9.7	11.3	7.6	N/A	N/A
TOP 1000* CORPS.	13.2	11.4	10.4	3.2	2.8	2.9

SOURCES: Business Week, "Scoreboard Special, 1985," "The Top 1000, 1986," "Corporate Scoreboard, March 16, 1987." RHC averages are weighted averages. Yields is defined as annual dividends as a percent of market price.

* 1986 12 month average is for the top 900 corporations.

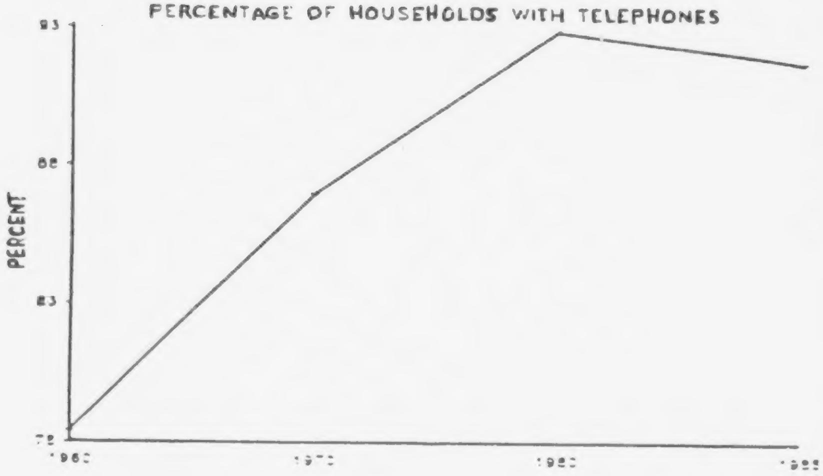
D. A Break With Historical Trends

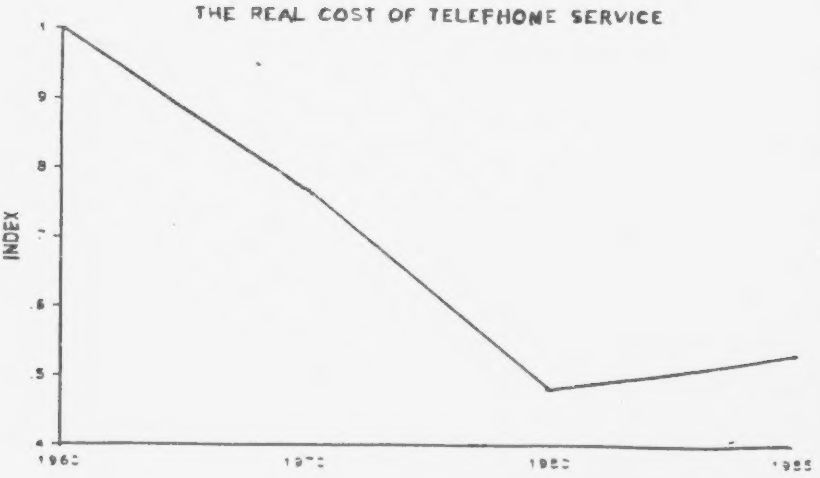
Recent telephone rate increases run against the grain of the telephone industry's historical trend toward cost reductions resulting from technical innovation. Between 1940 and 1980, the real cost of phone service (factoring out inflation) declined significantly as technological development and network expansion brought a telephone to about 93 percent of American households.[6] Yet since 1980, even with significant long distance rate reductions, overall telephone rates have risen much faster than inflation.[7] Most significantly, the price of phone service is rising much faster than the price of its key component parts (e.g., labor, computers).[8] Although all indications show that telecommunications has been, and should continue to be, a declining cost industry, telephone rates in the 1980's defy this logic. As a result of this reversal in the historical decline of real telephone costs, progress toward our nation's 50 year goal of universally affordable phone service has been stalled (see Figure 1).

E. Phone Company Cost Savings Resulting From Federal Tax Reform

In addition to the local and long distance rate reductions consumers should receive as phone company profits are brought in line with market conditions, ratepayers should benefit from federal tax reform. Since the maximum corporate tax rate is falling from 46 to 34 percent as a result of last year's tax reform legislation, consumers should reap significant savings

FIGURE I


PERCENTAGE OF HOUSEHOLDS WITH TELEPHONES


THE REAL COST OF TELEPHONE SERVICE

Source: Bureau of the Census, 1960, 1970 and 1980 Census of Population and Housing; Current Population Surveys, March 1983 - July 1985.

Bureau of Labor Statistics, Consumer Price Index from the decline in telephone company expenses. In 1987, RHC tax liability will decline by about $450 million, and then drop by about $900 million in 1988.[9] Since consumers are being charged through their current telephone rates for greater RHC tax expenses than the companies will ever have to pay, CFA believes local rates should be reduced to reflect the new tax law. Yet unless state regulators or the federal government affirmatively act to require a pass-through of corporate tax savings, the RHCs will receive a $900 million annual windfall.

F. Time For Rate Reductions

With appropriate regulatory intervention, both local and long distance rates ought to be falling simultaneously. If regulated local and long distance companies were allowed to earn no more than everyone else in the marketplace, and required to pass through tax savings, intrastate charges could be reduced by almost $4 billion and the FCC's more than $600 million in interstate rate of return reductions could be significantly augmented.[10] Today's marketplace provides the perfect opportunity to convince the American people that the Bell system breakup can bring the benefits of increasing competition without undermining affordable local phone service. If regulators would ensure that ratepayers receive their fair share of the benefits from reduced taxes and a low-inflation economy, consumers may forget their skepticism of the Bell system breakup. Unfortunately, regulators have allowed the RHCs to defy the realities of the marketplace and earn excessive profits, and would face additional pressure to raise local rates if the MFJ restrictions were lifted.

IV. PROBLEMS WITH THE DEPARTMENT OF JUSTICE REPORT

Throughout its February 2, 1987 Report and Recommendations to Judge Greene, which recommends lifting almost all the restrictions imposed on the BOCs in the MFJ report, the DOJ paints a picture of a new procompetitive regulatory model, created by the FCC, which reduces the need for the line-of-business restrictions. The DOJ chooses to focus almost entirely on the newly-adopted Computer III[11] and Joint Costs[12] rules and

BOC Structural Relief Order.[13] Other regulatory proceedings, which have negative ramifications for consumers are either ignored or ill-described. Not described as well are the tentative and undeveloped characteristics of the Computer III and Joint Costs proceedings. As for state regulation of the BOCs, the Justice report briefly notes that regulation plays an important role in preventing cross-subsidization of competitive ventures from the ratebase. While the DOJ has concentrated on the details of state policies that have impeded the growth of competition at the local level, the Department has failed to notice that more and more states are being pressured by the RHCs to eliminate the regulatory tools that the DOJ considers important to prevent monopolistic practices.

A. Reliance On The Joint Costs Rules: Hidden Local Rate Hikes?

The Joint Costs decision may conceal a renewed effort to shift network, common costs into local monthly charges. Despite the fact that many of the nonregulated services contemplated by the FCC and covered by the Joint Costs Order will use the same $30 billion worth of non-traffic sensitive (NTS) loops, switches, other central office equipment and network transmission facilities used to provide basic service, the FCC believes that between 80 and 90 percent of all costs can be allocated on a cost-causative basis, either directly, through analysis of the origins of the costs themselves, or indirectly, through some logical linkage of cost causation to a directly assigned cost.[14]

Cost causation, when applied to new, competitive services and their investment costs and operating expenses, may prove a helpful approach to a difficult regulatory task. However, the logic of the Commission's Access Charges Order and related decisions,[15] dictates that the end-user (i.e., the ratepayer) is the cost-causer for a substantial portion of already existing network costs, those considered non-traffic sensitive. If this philosophy is applied in the separation of regulated from nonregulated costs, and the FCC's consistent adherence to this pricing theory along with its astonishingly low estimate of common costs supports this assumption, then all NTS costs will be placed into the separations process as regulated costs directly assigned to the end-user.[16] Since DOJ and Mr. Huber inappropriately believe that local phone rates are currently subsidized, they show inadequate concern that lifting the line-of-business restrictions would enable the BOCs to subsidize competitive ventures with revenue from monopoly services. By supporting the FCC's Access Charges Order theory of shifting all NTS costs onto end-users' monthly phone bills, the DOJ by definition would reduce the pool of interstate-access common costs to be allocated through the regulatory process by billions of dollars.

Once one assumes that these common costs are eliminated from what Mr. Huber describes as the "inescapably arbitrary" process of allocating joint costs among separate activities,[17] it comes as less of a surprise that the DOJ has developed greater faith in the ability of regulators to prevent cross-subsidization. After all, as Mr. Huber points out, the more common costs, like loop costs, are redefined as direct costs caused by the end user, the less likelihood that regulatory misallocation of common cost will substantially impair competition: "First, full implementation of the FCC's $6.00 SLC would cut revenues from ICs to LECs in half. The less there is to dissect, the less it matters exactly what size pieces finally emerge."[18] On the other hand, if CFA, has misunderstood the FCC, DOJ and Mr. Huber's categorization of loop and other common NTS costs under the Computer III, Joint Costs, and Access Charges proceedings, lifting the line-of-business restrictions would open the door to widespread price discrimination by overwhelming the regulatory process with a large pool of common costs. If the Justice Department's definition of joint costs, "cost incurred even if only the regulated service were provided,"[19] is intended to include loop, switching and other central office NTS costs, as CFA believes it should, it is difficult to understand why the Department expects the FCC's new regulatory rules to prevent the cross-subsidies that no other regulatory approach could manage in the past. As Mr. Huber points out:

> The regulatory history of separating costs between local and interexchange businesses is one of rampant and often deliberate cross-

> subsidy, blessed if not actually required by various regulatory bodies. Cost separation is torture of a thousand cuts... Each slicing operation involves a measure of discretion. The discretionary judgments at each tier of the dismemberment multiply... If there is a 20 percent discretion as to just where each cost cut will be made, there is a 250 percent discretion as to the size of each small piece that finally emerges.[20]

B. Shortcomings Of Regulation Through Accounting Separations

The FCC has made it clear that its accounting system will not serve the purpose of determining whether nonregulated products and services are priced anticompetitively low.[21] The Joint Costs Order allocation method will not determine the costs of various services and products but will instead distribute costs into the two categories of regulated and nonregulated. The FCC notes "that competitors in nonregulated markets must rely for protection on the antitrust laws and the standards which apply in the antitrust arena."[22] The Department of Justice maintains that the MFJ is not intended to address the issues of ratepayer protection, but rather the effect on competition in markets the BOCs seek to enter.[23] However, it apparently detects no problems in proposing as protection against anticompetitive conduct regulatory measures which, on their face, are not designed to prevent anticompetitive practices.

As the Court in the AT&T case recognized, the FCC has little authority to vindicate injury to competitors and is unable to adopt remedies designed to foreclose future anticompetitive conduct.[24] Nothing has changed to render that observation invalid. It is therefore not surprising that the Joint Costs comes with its own warning that it is not meant to be interpreted as an antitrust panacea.

Even if the Joint Costs Order were designed for the purposes that the DOJ would now like to ascribe to it, it is by no means certain that the FCC will be able to overcome the inherent problems of behavioralistic accounting controls, i.e., difficulties in oversight and intrusiveness.[25] The BOCs will have to devise cost allocation manuals based on the guidelines presented in the Joint Costs Order. In the "regulatory cuisinart," as Peter Huber refers to it, discretion is multiplied by discretion, such that the BOCs retain considerable flexibility in allocating costs. Reliance on the Joint Costs Order as a curb to anticompetitive cost-shifting, if not misguided, is at least premature until a proven cost allocation mechanism is in place.

The DOJ realized the inherent shortcomings of accounting controls in its response to the Tunney Act comments which it filed with the Court on May 20, 1982. The DOJ then noted there is no single formula for the allocation of common costs and that the BOCs, sole possessors of the relevant cost information, would have a high degree of flexibility in presenting these costs for regulatory treatment.[26] If, because of Congressional intervention or some other change in circumstances, the FCC does not effect the NTS cost-shift to local rates described above, then the problems inherent in the Joint Costs decision's accounting mechanism will be multiplied, because the large pool of NTS costs to be covered by carrier charges will increase the possibilities for price discrimination.[27] Even with the NTS cost shift advocated by the FCC, the DOJ, and Mr. Huber, the RHCs will retain the incentives and opportunity to shift costs to their monopoly services at every juncture of the accounting process, just as the DOJ perceived in 1982.

C. Reliance On The Computer III Model To Curb Anticompetitive Conduct Is Misplaced And Premature

There are two major concepts described in the FCCs' Computer III decision, comparably efficient interconnection (CEI) and open network architecture (ONA). Neither is yet a reality. Only one CEI plan has yet been filed.[28] ONA plans are required to be filed by February 1, 1988, but no technical standards have yet emerged which are broadly supported in the industry. Indeed, the forum initiated by Bellcore to discuss ONA plans and potentialities among a wide variety of providers and users has been marked by the reticence of BOC representatives regarding the standards that can make ONA a reality and a reluctance to discuss their companies' network capabilities.

This reticence is understandable and of paramount importance when compared with the process of providing equal access to long distance carriers. Unlike the MFJ's equal access requirements for provision of local exchange access to interexchange carriers with whom the BOCs are not allowed to compete, the CEI/ONA equal access concept is meant to apply to the BOCs' enhanced services as well as those of their competitors. The BOCs are thus not disinterested parties merely providing access to their networks to other service providers, as in the present case of interexchange access. The BOCs will initially devise standards for interconnection to all underlying switching and transmission service, provided through the monopoly local exchange, for services with which they will be in direct competition.

The conversion to equal access for interexchange, inter-LATA carriers, while overall a remarkable success, has had some difficulties that have been ascribed to BOC intransigence. [29] Even with BOC "neutrality," 25 percent of lines have still not converted to equal access for interexchange service. [30] The FCC's CEI equal access conversion plan, by contrast, has no timetable for network conversion before the restriction on BOC entry into the information services market is relaxed, relying instead on BOC plans submitted for public comment and FCC approval before a particular service can be initiated. [31] In addition, the BOCs must submit quarterly reports designed to compare the level and quality of basic service provided for their new offerings and those of competitors. "Equal access" under the CEI approach is thus an after-the-fact determination. Therefore, it would be more sensible to await full implementation of ONA, as with interexchange access, before considering whether or not to allow the BOCs to compete in the information services market.

D. Effect of Diminished State Regulatory Authority

Although the DOJ Report warns that removal of the line-of-business restrictions without appropriate regulatory scrutiny would enable the BOCs to misallocate costs, [32] the Department fails to evaluate the effect that current state deregulatory efforts will have on the ability of state regulators to monitor cross-subsidization. In the course of the last 3 years, a number of RHCs, particularly U.S. West, have been flexing their substantial political muscles to convince state policymakers to limit state regulatory authority over cost allocation (see

Appendix A). Whether described as deregulation, social contract, or price stabilization plans, these proposals invariably involve severe limitations on state regulators'ability to allocate costs among basic and other services and regulate services not subject to substantial competition.

While it is unclear whether or not this deregulatory trend will spread across the entire nation, it is absolutely clear that neither the DOJ nor Mr. Huber's report adequately considered the implications of these changes in their extensive description of recent regulatory changes. [33] This omission is even more glaring given that the Department of Commerce's National Telecommunications and Information Administration is about to make recommendations concerning alternatives to rate-base, rate of return regulation that may have major impact on both state and federal regulatory practices. [34]

Since the DOJ failed to look at these developments in state regulation, it is impossible for CFA to support the Department's contention that state regulation is adequate to prevent misallocation of costs. If more and more state regulatory authorities are prevented from allocating costs and regulating the rates charged for services subject to little or no competition, CFA believes that without the line-of-business restrictions, it would be impossible to prevent the BOCs from cross-subsidizing any manufacturing, information service, interLATA service, or other competitive offering. It is already impossible in some states, and likely to be impossible in many more, for state regulators to prevent the type of cross-subsidization that the DOJ assumes regulators have the authority and ability to stop. [35]

E. DOJ Politics

> The provisions of Section II... limit the functions of the divested BOCs to preclude the possibility of a recurrence of the type of monopolizing conduct that the United States alleges to have resulted from A.T.&T.'s ownership of regulated local exchange carriers and its simultaneous participation in competitive, or potentially competitive, markets. [36]

This excerpt from the Department of Justice's position in 1982 was presumably based on its interpretation of the massive amount of evidence it presented as its case in chief in March through June of 1981. But Peter Huber, in his mannered and extensive presentation, states that the Bell System was incapable of monopolizing the electronic information-service markets in 1982. [37] The 1987 Justice Department finds truth in Huber's analysis. But the facts have not changed, at least not significantly. [38] The Department of Justice has.

It appears that the increasing willingness of the DOJ to rely on FCC regulation for antitrust purposes is directly proportionate to the accelerating pace of FCC deregulation. The Department of Justice seized on the Notice of Proposed Rulemaking [39] in Computer III to urge the FCC to adopt antitrust precepts as the basis for its regulatory treatment of enhanced services, including the use of a separate subsidiary requirement as appropriate. [40] The DOJ's comments in Computer III are indicative of an evolving position which has culminated in its report to the Federal District Court -- that the rate regulator should be the antitrust enforcer, a role the FCC has explicitly rejected.

Yet in contrast to the DOJ's changing perspective, the Huber Report makes it clear that 75% of all local exchange switched lines are for residential service, [41] "serious competition to serve smaller users has not yet arrived," [42] and small users have virtually no alternative to local exchange carrier monopoly service. [43] This is practically the same situation which existed in 1982 for these subscribers. The BOCs essentially remain monopolists. Other changes in the industry notwithstanding, the monopoly bottleneck continues.

V. ELIMINATION OF THE LINE OF BUSINESS RESTRICTIONS WILL POSE A SIGNIFICANT DANGER OF ANTICOMPETITIVE CONDUCT

The Department of Justice makes the case that BOC cross-subsidization of competitive activities from monopoly revenues does not create an antitrust issue if the only effect is to permit the BOCs to earn monopoly rents closer to what they would achieve in an unregulated market. But this observation merely restates the crucial question of whether the BOCs will use their monopoly power in an anticompetitive manner. Their incentives cannot be judged to have changed from the days before divestiture. They wish to retain their local and intra-LATA monopolies and to reduce the level of state and federal oversight of these operations. They wish to benefit from seamless integration of local switching capacity with new technology. They also wish to diversify into a myriad of new areas, some directly linked to telecommunications, some not. Rate increases approaching the level of monopoly rents -- over $5 billion in new revenue since divestiture -- provide the financial wherewithal to dominate the provison of competitive services at the local level, to distort the market for network equipment, and to launch interexchange services which will not significantly advance broad-based competition in that market, but will divert attention and resources from local service.

The two major flaws in the Department of Justice analysis of competitiveness in the telecommunications environment are its overly-optimistic view of the regulatory structure which the FCC has begun to implement, and its misperception that control of local switches and local loops in the public-switched network would not be a significant hazard to the competition which has mushroomed in recent years in adjacent telecommunications submarkets. The DOJ does not seriously argue that the BOCs incentives have changed, merely that they will have reduced opportunities to undermine competition. As stated above, CFA believes that the regulatory safeguards upon which the DOJ relies are inadequate. In addition CFA believes that the BOCs retain sufficient technical control and financial power to engage in precisely the same kind of anticompetitive conduct which the DOJ challenged in the proceedings leading to divestiture.

A. Monopoly Control of the Local Exchange Has Not Receded

The Huber Report acknowledges that residential telephone service is a natural monopoly. [44] Despite the Huber Report's fascination with private networks and the ascendency of the PBX for in-house business communications,there is no question that even the largest users depend heavily on the local exchange. [45]

Even among companies that have the financial resources, service requirements, and economic incentives to bypass the local exchange to one degree or another for access to interexchange services, telephone companies generally provide 75 to 90 percent of these users' total telecommunications traffic. [46] The fact that large businesses prefer to switch their own in-house communications through PBXs in no way undercuts BOC domination of local exchange telecommunications. Mr. Huber estimates that 97% of all inter-LATA traffic uses local exchange facilities, and that at least 86% of all inter-LATA calls are switched through the local exchange network. [47] The force that controls the local loop and its end-office controls the network. [48] The DOJ has not shown that there has been such a staggering pace of technological development in the last three years that the rationale for the line of business restrictions is outmoded.

B. The RHCs Possess Greater Financial Power Today Than at the Time of Divestiture

In the aftermath of divestiture, the BOCs immediately went before the state public utility commissions and requested massive rate increases, arguing that they were at risk because of the separation of the long distance business and the rest of AT&T from their operations. They pressed for more rapid depreciation schedules and a shift from debt to equity in their financial structures, even though arguments were made that divestiture would not increase the BOCs' cost of capital. [49]

As pointed out above, in 1986 the RHCs' average rate of return on equity was over three percentage points more than the average return of the nation's largest corporations and 2.5 points higher than the average for other utilities. Because no competitive risks have materialized and inflation has substantially declined, the RHCs have been able to defy the purposes of rate-of-return regulation and reap substantial windfalls.

The DOJ has argued that state PUCs should take action to allow interexchange carriers to compete with the BOCs in the intra-LATA long distance market. Just as significant for the successful evolution and preservation of competition in markets which the BOCs wish to enter is the reduction of excessively high rates now borne by local exchange customers. Excessive monopoly revenues can fuel expansion into new markets, even as unprofitable ventures, either directly through cross-subsidy, or indirectly by stock offerings made attractive to investors by the extremely high rate of return on equity. In either case, consumers pay more and the RHCs' management is not bound by market forces in its determinations of risk.

VI. ELIMINATION OF THE LINE OF BUSINESS RESTRICTIONS WOULD THREATEN THE GOAL OF UNIVERSAL SERVICE

For the same reasons that neither the marketplace nor the regulatory process prevent unrestricted RHCs from undermining competition through cross-subsidization, CFA is concerned that lifting the line-of-business restrictions would intensify pressure to raise the price of monopoly, basic phone service and thereby threaten universal service. Without the restrictions, regulators -- to the extent they retain any authority at all -- would be unable to prevent the BOCs from overallocating the cost of jointly used personnel, equipment and other resources to monopoly, basic phone service.

While the DOJ does not seem concerned about threats to universal phone service,[50] CFA believes policymakers should view affordable, universally available phone service as the highest priority of our telephone system. Consumers have borne more than their fair share of the risks associated with the Bell breakup. If further changes are required, CFA believes that those who demand change -- not the general public -- bear the risks associated with a new restructuring of our phone system.

CONCLUSION

CFA believes the Department of Justice's report and recommendations are based on a myopic view of the markets where the line-of-business restrictions apply, an exaggerated perception of Mr. Huber's "geodesic network" and the new technology built into that network, an overly-optimistic view of regulatory protection, and an incomplete understanding of the monopoly power the BOCs and their parent holding companies can exert through their control of local telephone service. The opportunities and incentives to abuse that monopoly power have not diminished. Subscribers of local telephone service would be harmed if the attention and financial resources of the Bell Companies became focused on entering new markets, undercutting their competition, and increasing monopoly, basic-service rates. CFA opposes further changes in the structure of our telephone system unless and until consumers are assured that basic phone service will remain affordable to all Americans.

ENDNOTES

1. Mark N. Cooper and Gene Kimmelman, Divestiture Plus Three: Still Crazy After All These Years (Consumer Federation of America, December 1986), page 1.

2. *Id*. page 2.

3. Mark N. Cooper, Local Rate Increases In the Post-Divestiture Era: Excessive Returns to Telephone Company Capital, (Consumer Federation of America, September 1986), p. 2, p. 10.

4. *Id*., page 36.

5. Authorized Rates of Return for Interstate Services of AT&T Communications and Exchange Telephone Carriers, CC Docket No. 84-800 Phase II, Memorandum Opinion and Order on Reconsideration, adopted August 7, 1986, released August 25, 1986.

6. Local Rate Increases, *op. cit*., page 6; Telephone Communications: The FCC's Monitoring of Residential Telephone Service (U.S. Government Accounting Office, Washington, D.C., June 1986), page 16.

7. Divestiture Plus Three, *op. cit*., page 2; Local Rate Increases, *op. cit*., page 6.

8. Local Rate Increases, *op. cit*., page 8.

9. See Statement of Gene Kimmelman Before the House Telecommunications and Finance Subcommittee, April 2, 1987, Appendix A.

10. Conversation with Bert Halprin, Chief, Common Carrier Bureau, FCC, March 3, 1987.

11. Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), CC Docket No. 85-229, FCC 86-252 (release June 16, 1986).

12. Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities (Joint Costs Order), CC Docket No. 86-111, FCC 86-564 (released February 6, 1987). As DOJ acknowledges on page 32 n.69 of its report, this document was not yet released at the time the report was prepared. CFA will not belabor the obvious questions raised by reliance on a press release.

13. Furnishing of Customer Premises Equipment by the Bell Operating Telephone Companies and the Independent Telephone Companies, CC Docket No. 86-79, FCC 86-529 (released January 12, 1987).

14. Joint Costs Order, op. cit., at paragraph 162 and n.280.

15. Third Report and Order, MTS/WATS Market Structure, 93 F.C.C.2d 241 (1983); First Reconsideration Order, 97 F.C.C.2d 682 (1983); Second Reconsideration Order, 97 F.C.C.2d 834 (1984); Recommended Decision, CC Docket No. 78-72 and 80-286, 49 Fed. Reg. 48,325 (1984); Subscriber Line Charge Order, 50 Fed. Reg. 939 (1984).

16. Even though the FCC has been pressured by Congress to slow down implementation of the subscriber line charge, the Commission persists in transforming long distance costs into local charges through changes in the separations process (i.e., shift interstate NTS into the intrastate jurisdiction).

17. P. Huber, The Geodesic Network, 6.39 (January, 1987) ("Huber Report").

18. Id. at 3.55.

19. DOJ Report at 145 n.289.

20. Huber Report op. cit., at 3.53 - .54.

21. Id., at paragraph 40.

22. Id., at paragraph 110.

23. DOJ Report, op. cit., at nn. 100-101 and accompanying text.

24. United States v. AT&T, 461 F. Supp. 1314, 1328 n.48 (D.D.C.1978).

25. See BOC Separation Order, 95 F.C.C.2d 1117, 1136-37 (1983).

26. "Response of the United States to Public Comments on Proposed Modification of Judgement," 57-58 (May 20, 1982).

27. See Huber Report op. cit., at 3.53 - 3.55.

28. Bell Atlantic Telephone Companies' filing of March 6, 1987 to provide CEI for a voice storage/retrieval service. The FCC has not yet acted on this recent request.

29. See Huber Report op. cit., at 3.13 - 3.17 and accompanying footnotes.

30. Id. at 3.15.

31. Computer III, op. cit., at paragraph 190-91.

32. DOJ Report, op cit., at 48-49.

33. See Huber Report op. cit., at Appendix D, for the only discussion of state regulatory trends.

34. Notice; Request for Comments, Comprehensive Review of Rate of Return Regulation of the U.S. Telecommunications Industry, 51 Fed. Reg. 36837, October 16, 1986.

35. DOJ Report op. cit., at 124, 129, 147-8 and n.294, 166.

36. Competitive Impact Statement, 50 Fed. Reg. 7170, 7175 (1982).

37. Huber Report op. cit., at 1.30.

38. Selwyn and Montgomery, "Factual Predicates to the MFJ Business Restrictions: An Analysis of the Huber Report" (March 12, 1987).

39. CC Docket No. 85-229, 50 Fed. Reg. 33581 (August 20, 1985).

40. See Comments of the Department of Justice, Computer III, at 3, 38 (November 13, 1985).

41. Huber Report, op. cit., page 2.5.

42. Huber Report, op. cit., at page 2.12.

43. Huber Report, op. cit., at page 2.25.

44. Huber Report, op. cit., at page 21.1 n.1.

45. See Factual Predicates, op. cit., note 38.

46. General Accounting Office, Bypass of the Local Telephone Companies, 41, GAO/RCED 86-66 (August 18, 1986).

47. Huber Report op. cit., at 1.20 (chart).

48. See Factual Predicates, op. cit., at note 38.

49. Evans and Rothschild, "Impact of Divestiture on the Cost of Capital to the Bell System," in Breaking Up Bell: Essays on Industrial Organization and Regulation (D.S. Evans, ed. 1984).

50. DOJ Report op. cit., at 47.

APPENDIX A

Newspaper Articles Describing State Deregulation Initiatives

Many States Deregulate Telephone Rates, Hurting Residential Users in Short Run

By Bob Davis
aff Reporter of The Wall Street Journal

Telephone deregulation is sweeping the ates, promising consumers new technol- y while threatening to drive up rates.

Fifteen states have adopted deregula- in plans and at least 11 more are consid- ing such measures. The laws generally ow telephone companies to charge what ey want for certain services.

The big winner in deregulation is big siness; the loser, at least in the short m, is the residential customer. States d the federal government say they are minating rate subsidies for local resi- ntial calls and rural phone systems. iephone companies are using the addi- nal revenue to cut the rates they charge sinesses for long-distance and other vices.

Deregulation "can't work unless resi- itial prices go up," says Fred Konrad, official at the Illinois Bell unit of Ameri- h. "That might seem harsh, but free- rket pricing means you can't have sub- ies."

Advocates maintain that competition l limit rate increases in the long run d spur innovation. But critics charge t decontrol is a smokescreen obscuring ge rate rises.

Phone-company lobbyists press two in arguments for deregulation. They the companies' monopoly power—the ginal rationale for regulation—is waning ause of increased competition. And the byists promote a trickle-down theory of phone economics.

Phone companies must be free to re- e commercial rates, this theory goes, else big businesses will bypass local phone networks and build their own. A dy by the General Accounting Office, gress's research arm, says bypassing uld significantly revise local telephone npany revenues."

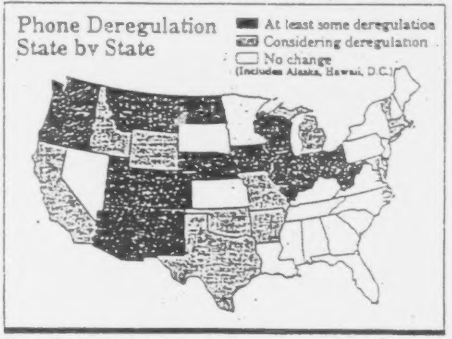
Phone companies say that if they lose iness revenue, other customers must ke up the difference. In other words: egulation helps everyone by helping companies keep business customers.

Some state regulators agree with the npanies' thinking. "Imperfect competi- is better than imperfect regulation," s Cale Case, a telecommunications ana- for the Illinois Commerce Commis- . "Every market will seem like the ght of imperfection, but it will work bet- than regulation."

But some people see more harm than d in deregulation. Gene Kimmelman, legislative director of the Consumer eration of America, says rate increases i't justified, because the regional Bell companies are hugely profitable. The coalition of consumer groups claims those companies have overcharged consumers more than $3 billion since the 1984 breakup of American Telephone & Telegraph Co. (The companies deny that.)

State telephone deregulation "is an amazing sleight of hand" that will lead to more overcharges, Mr. Kimmelman adds.

Many regulators oppose deregulation. In Idaho, a deregulation bill cleared the Senate but died in the House. Perry Swisher, the state's top regulator, says the bill would have dismantled subsidies protecting rural communities.


Phone Deregulation State bv State
At least some deregulation
Considering deregulation
No change
(Includes Alaska, Hawaii, D.C.)

In other industries, Mr. Swisher says, "deregulation has hurt us already: We don't have airline access in small communities; we don't have railroad service." He vows, "We don't intend to let this happen with telecommunications."

Jack MacAllister, the chairman of U S West Inc., a regional phone company, dismisses the critics as "regulators who don't want to walk away from their job."

In any case, the push to deregulate seems to be too strong to derail for long. AT&T and the regional phone companies have dispatched dozens of lobbyists to state capitals to push deregulation. Local residential rates have risen roughly 25% to 35% since the AT&T breakup (in part to offset deregulated interstate rates, which have dropped about 20%). Some states fear even steeper increases in local rates. That provides fertile ground for lobbyists who claim state deregulation would hold down rate increases in the long run.

"We have been hyper-involved," says Gerald Lowrie, AT&T's chief lobbyist. "In Illinois we had one person who, I think, didn't even return home weekends when the legislature was in session." Persistence paid: AT&T now can charge any rate for non-local intrastate calls in Illinois. It says it has such authority in 15 states.

State deregulation plans vary sharply. Washington state has authorized two smaller long-distance companies to set their own rates—but, at least for now, it still regulates the in-state rates of giant AT&T. Iowa says long-distance rates shouldn't be deregulated, but it permits Northwestern Bell, a unit of U S West, to set rates for private lines and a switchboard service called Centrex.

Vermont hasn't deregulated, but its top regulator, V. Louise McCarren, urges what she calls a "social contract." Under the plan Vermont would deregulate all phone rates but those for local residential calls. In return, Nynex Corp.'s New England Telephone unit would accept a formula for residential rate increases.

But critics charge that this type of plan actually builds inflation into residential rates. California regulators thus shelved a social contract proposed by Pacific Telesis Group's Pacific Bell unit and instead reduced telephone rates.

Nebraska has adopted perhaps the most sweeping deregulation plan. Over the objection of state regulators, the legislature deregulated long-distance rates and freed Northwestern Bell to set rates for local service. Regulators can step in only if local rate increases are more than 10% a year or if 2% of Nebraska phone customers petition for an investigation.

Gov. Robert Kerrey says the law will encourage telecommunications companies to operate in Nebraska and will lead to an explosion of communications services. But Harold Simpson, a Nebraska regulator, predicts disaster. "How do you force good service if you don't have a handle on rates?" he asks. The Public Service Commission is suing to have the law declared unconstitutional.

Meanwhile, some federal and state regulators say decontrol in most states seems inevitable. To deflate arguments that the poor would be hurt by higher local rates, the Federal Communications Commission has established a "lifeline" telephone subsidy. Seven states and the District of Columbia have adopted the program, which gives a $4-a-month price cut to low-income residents. Other states, including California, have established similar programs.

Wall Street Journal, Friday September 19, 1986 A-2

WALL STREET JOURNAL
MAY 12, 1986

Nebraska Law Deregulating Phone Rates May Spur Some Changes in Other States

By Johnnie L. Roberts
Staff Reporter of The Wall Street Journal

A new law in Nebraska deregulating local telephone rates is being closely watched by industry officials and analysts. Some believe it could be a revolutionary step toward deregulating intrastate rates across the country.

The law, effective January 1987, will allow telephone companies in Nebraska to raise local telephone rates as much as 10% during any 12-month period without seeking approval from the Nebraska Public Service Commission. If 2% to 5% of a telephone company's customers petition against the increase, however, the regulators will review it.

This legislation "is the wave of the future," said Richard Toole, an analyst with Merrill Lynch & Co. "I think it is almost a test case to the extent the rest of the nation will be watching."

U S West Inc., whose Northwestern Bell unit is the largest provider of local service in the state, said its plans to raise residential rates and lower rates for business customers, who have been subsidizing residential telephone services. U S West has been aggressively promoting the law.

Only a few states, notably Illinois and Wisconsin, have granted telephone companies more freedom to set certain rates. But Nebraska's law is unmatched in scope, greatly reducing regulators' role in setting rates while granting telephone companies near-absolute latitude to price services.

Moreover, it could spell the end in Nebraska of the allowable rate of return on capital that regulators establish for telephone companies. In essence, it could remove the lid on earnings capability, enabling efficient telephone companies to post whatever returns they are capable of achieving.

Securities analysts say rate-base deregulation is particularly important for the seven regional holding companies spun off in the Bell System breakup. That is because their customer lines generally aren't increasing robustly and unregulated ventures in which they are permitted to engage aren't expected to provide significant financial contributions until the 1990s.

The law will be challenged by Nebraska's attorney general, however, who charges that it denies customers due process of law and strips regulators of their constitutional authority. The public service commission vows not to implement it.

Telephone companies will be able to "charge whatever they see fit as long as it isn't unfair or in excess of actual costs, whatever that means," said Donald Adams, the commission's executive secretary. Moreover, he said, "without the power to regulate rates, the commission's power in all other areas is greatly diminished." He calls Nebraska a "bellwether state" in telephone companies' push to deregulate rates.

But Gov. Robert Kerry, who says he supported and signed the bill last month despite its unpopularity among constituents, disagrees. He argues that the bill will promote competition and more and better telephone service. "I don't think any business should have to go before a rate commission when it wants to change prices," he said in an interview. "In the next 10 years, we are going to be talking about quality and quantity of service. In the public policy arena, we shouldn't be arguing about price."

U S West has been perhaps the most aggressive of the seven regional companies in pushing for more telecommunications deregulation, especially at the state level on pricing issues. With 14 states to serve, its region is the largest while its access lines are increasing at one of the slowest rates.

In Nebraska, "we can price services without the subsidies now inherent in regulation," said Howard P. Doerr, U S West's chief financial officer. The basic residential rate currently is $15.68 monthly, but the actual cost is $23 to $25, Mr. Doerr said. The $38 monthly rate paid by businesses and prices that any customer pays for special services are inflated to subsidize residential customers, Mr. Doerr said.

Mr. Doerr, who brought news of the law to Wall Street analysts last week, added, "we're trying to get deregulation so we can price service to make it less attractive" for businesses to bypass U S West's network with private networks.

Kathy Rauch, manager of state and federal affairs for the U.S. Telephone Association, a Washington-based trade group, notes that many states are pondering rate-base deregulation. But analysts say political and economic factors will discourage many states from quickly copying Nebraska's approach. Small states may take Nebraska's lead, but "you aren't going to see the dominos falling," said Jack Grubman, an analyst with PaineWebber Inc.

A-4 The Denver Post/Sunday, January 11, 1987

MOUNTAIN BELL DEREGULATION

Nebraska reform bill a surprise to public

By Peter G. Chronis
Denver Post Business Writer

Nebraska's recently enacted telephone reform bill took the public by surprise after Northwestern Bell and the independent Lincoln Telephone Co. launched a successful lobbying campaign in the state legislature.

The Nebraska telephone price-decontrol bill is being used as a blueprint for other units of U S West Inc., including Mountain Bell, that want to free themselves from control by state public utilities commissions. Similar deregulation pushes are afoot in 14 states.

Consumer resistance came too late to be effective, a principal opponent of the Nebraska measure said. And both the public and most legislators were woefully uninformed about the bill.

But the bill now seems mired in litigation.

Nebraska's new law was scheduled to take effect Jan. 1, said Don Adams, executive secretary of the Nebraska Public Service Commission, but the commission voted unanimously to file suit, charging the new law deprived Nebraska citizens of due process of law.

10% increase rule

A trial was concluded Dec. 11, and a decision is pending but ultimately, Nebraska's Supreme Court will likely settle the issue.

The bill basically allows the phone companies to set their own rates as long as increases don't exceed 10 percent during any 12-month period, Adams explained. However, it only takes a complaint from 2 percent of Northwestern Bell's users to bring in the PSC.

The 10 percent cap will be in place five years — after that, phone companies can charge whatever the market will bear.

"I would suspect they'd hold off instituting that," Adams said. "They're using Nebraska as a bellwether of how easy and painless it's been to encourage other legislatures to adopt a similar bill."

For toll calls, Nebraska phone companies simply must file a rate list 10 days prior to instituting new rates.

"I've been here 18 years and have never seen such an attack of lobbying as the one that took place," said State Sen. Loran Schmit, a Republican from Bellwood, Neb. "The telephone companies had virtually every major lobbyist in the state hired, plus the fact that the industry had dozens and dozens of executives in the Rotunda. They virtually lived with the legislators to make sure they kept the votes."

Called license to steal

Schmit, who staunchly opposed the law passed and had offered an alternative bill, decried the act as "not true deregulation. It's the best kind they can get — it deregulated the pricing mechanism but they can keep their territorial rights. .. It's a license to steal, sanctioned by statute."

By preserving monopolies on local service, the new act protects the state's two largest telephone companies from competition "while they make changes so nobody can compete," Schmit said. Nebraska has about 60 telephone companies, but Northwestern Bell and Lincoln Telephone have the lion's share of the market.

Although currently, local service isn't likely to attract competitors because of financial and technical constraints, the telephone giants want to "freeze everybody out, so when the technology catches up, say in four or five years, they'll make sure the competition isn't there," Schmit said.

Even the Bell bill's sole sponsor and principal advocate, Sen. John DeCamp, a Neligh, Neb., Republican, concedes the bill wasn't complete deregulation. "With respect to territory and the competitive aspect, it did not totally deregulate the industry," he said. "There's still a lot to go. . . I hope it gets completed."

'Bypass' magic word

DeCamp, a salty, plain-speaking lawyer who was defeated in his reelection bid, believes total telephone deregulation is inevitable because of federal action that opened the industry to competition in long-distance service. "Once you've done certain things, certain things follow. The only thing you can do is complete deregulation."

Subsidizing local service by charging higher prices for long-distance service works only in a "closed loop," DeCamp said. "When the door was opened by the feds who said, 'Look, you can bypass,' — that's the magic word, bypass — that began the total collapse of the system."

"The subsidy the local telephone companies were getting from Joe Businessman is no longer there," DeCamp said. "Very quickly, the noose tightens on the ability to subsidize the guy paying very low rates. . .Once you crack the regulatory system, anybody paying rates that are too high is going to escape."

DeCamp said Northwestern Bell and Lincoln Telephone, with their backs to the wall on local service, had little choice but to seek deregulation. Despite misgivings about how the public would perceive the bill, DeCamp, a free-market advocate, said he supported deregulation. "You can either fix the machine now and face the fact [illegible] are part of a global economy or you can hide and deny it for three or five years, and then it's even more painful," he said.

But Schmit disputes things are so bleak for local telephone companies. His basic residential phone bill in a small town is $7.50 a month, while the rate in Omaha is twice that, Schmit said. "The industry claims that it costs them about $20 to service a residential customer. If that's true, why aren't they all bankrupt?"

Schmit claims the law will cost local government and other Nebraska businesses and industries "tens of millions of dollars."

Nebraska consumers didn't have much time to organize opposition to the act, Schmit said. "We were so outgunned lobbying-wise that it was like trying to hunt grizzly bear with a .22-caliber short bullet — you just couldn't do it," Schmit said.

Senator METZENBAUM. Thank you, Mr. Kimmelman.

Mr. Alford, I want to ask you, you make a statement the overall price of telephone service is down. Now I gather you mean that for commercial users, because Mr. Kimmelman has just testified that the rates generally are up 20 percent, according to the Bureau of Labor statistics, and that local rates are up 40 percent.

How would you respond to him?

Mr. ALFORD. I don't believe that the census data shows that local rates are up 40 percent. Number one, I believe his study is based on a Michigan study. You mentioned Ohio. I had the responsibility for the BellSouth Corporation's operations in Florida from 1982 through April of 1986. We didn't increase local rates one nickel. They haven't gone up since 1977. Right after I left, they were reduced as a matter of fact in BellSouth.

Senator METZENBAUM. What about Ohio? You said I mentioned Ohio.

Mr. ALFORD. BellSouth doesn't serve Ohio. I am taking your word for the 40 percent. I have no idea.

Senator METZENBAUM. Oh, it is up more than 40 percent in Ohio. It's 37——

Mr. ALFORD. Excuse me, the overall rate for telephone service, if you take the mix the consumers were buying, before divestiture, and you take it today, the price of that telephone service is down. There has a lowering of toll rates because of the shift from the toll rates to the local loop. Those rates have been reduced, the toll rates have reduced.

If you take the whole package of telephone services, they have actually been reduced. It is just like saying——

Senator METZENBAUM. I am talking about consumers, Mr. Alford. I am not really talking about business groups—they can handle themselves, they can buy alternative services. They can develop some other ways of proceeding.

I am talking about the average household user of telephones. I'm not talking about their long distance calls. I am just talking about the ability to call their local doctor, their grocer, their friends.

Mr. ALFORD. Well, Florida is 25 percent of BellSouth, and every consumer that is served by Southern Bell is paying a lower price than they were paying in 1977 in that State. The rates——

Senator METZENBAUM. What about the rest of BellSouth? You tell me about Florida.

Mr. ALFORD. The rest of BellSouth, when you put the total package of telephone service together, and to do otherwise——

Senator METZENBAUM. I am not asking you that. I am asking you about the consumer. You tell me about the consumer rates going down in Florida. Now I am asking you about the rest, the other 75 percent of your business that BellSouth handles for the consumers. Are those rates up or down?

Mr. ALFORD. They are down.

Senator METZENBAUM. They are down just for the local service?

Mr. ALFORD. If you look at the local service, which would be like looking at the CPI and taking the price of oil out of it and saying it has gone down 50 percent, you look at local service only, it is up about 20 percent.

If you look at the total package of telephone service, it is down.

Senator **Metzenbaum**. Aren't you talking about the total of telephone service, including commercial service?

Mr. **Alford**. That's what people buy. You can't have a line connected to your house and not put an instrument on the end of it and use it.

Senator **Metzenbaum**. No. I am talking about business. I'm talking about business phones as compared to local telephones. I am talking about household service. I'm talking about what the people——

Mr. **Alford**. Yes. The average residential customer in our area, the price of his package of telephone service is down.

Senator **Metzenbaum**. Would you agree with that, Mr. Kimmelman?

Mr. **Kimmelman**. Not at all. I think he has a pretty funny mix of what you call phone service in order to get that result.

The numbers we are using are from the Bureau of Labor Statistics. The FCC has come out with its own study, and you can play with the numbers however you want. But phone service in this country on average, right before the breakup, used to cost most consumers $10 or $11 a month. And to get that exact same service today costs $15 to $16 with a Federal access charge and local rate increases.

Now, you can do it on an annual basis. You can do it over the three-year period, the numbers are the same. And they are up significantly higher than inflation. And I don't have the figures for the BellSouth region here, but I know there have been some rate increases there. I believe probably the 20 percent figure for local rates is accurate, 20 percent rise in local charges for residential customers, and then another 20 percent probably from the Federal access charge. I mean I think you are probably close to what has happened as a nation in general.

Senator **Metzenbaum**. Mr. Alford, I have something here from the Consumer Federation of America, regarding an allowance for inflation. Well, it is an overall figure. I don't think I am going to get into it. I will skip that. I withdraw that question.

But I will ask you this—if you want me to, I have no problem because it doesn't address itself to the issue that I have raised with you. So there is no misunderstanding about it, Mr. Alford, it does indicate that your increases have been substantially in excess of that provided, if you were just to get an inflation rate increase. So I didn't ask you the question, not because I didn't think it had some relevance, but I didn't think it had any relevance to my previous line of inquiry to you.

So that you are very welcome to look at it. I think it is on page ES-11. And I will ask the stenographer to put ES-11 of the Consumer Federation of America statement in the record at that place, in addition to including it in the record in its entirety—the entire statement in its entirety.[1]

Last September, the National Association of Regulatory Utility Commissioners, NARUC, said the telephone subsidiaries of the Bell Companies were functioning as "cash cows" and "talent pools" for the competitive new ventures. Now, the companies want to expand into long distance and other areas.

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[1] See appendix.

Isn't it likely that they will charge the ratepayer for these new activities just as they are doing now?

Mr. **Alford**. The ratepayer pays a price for telephone service that's regulated by the FCC and the State Commissions. And that price includes a return, a dividend and a return. When the ratepayer pays that money, that becomes the money—what is left becomes the money of the stockholders. If the stockholder, through the company, permits the company to invest that in something else, that is not the ratepayer paying for any new operations of the telephone company.

So the stockholders of BellSouth do have some small investments compared to what they have in telephone service in other activities other than telephone service. But we invested almost $8 billion since divestiture in telephone service as well.

Senator **Metzenbaum**. How much have you invested in outside services besides the direct telephone services?

Mr. **Alford**. The businesses we have outside the telephone business that we had at divestiture is considerably less than 10 percent of our total operations.

Senator **Metzenbaum**. How many dollars did you invest?

You just said you invested $8 billion back in the telephone business.

Mr. **Alford**. $8 billion in the telephone business, and considerably less than that, I would say considerably less than a billion dollars in the other businesses. But I will have to furnish that precise figure for the record.

Senator **Metzenbaum**. You may supply it subsequently.

How many separate corporations do you have now in BellSouth?

Mr. **Alford**. BellSouth owns three principal subsidiaries and two telephone companies in BellSouth Enterprises. It has some other small subsidiaries like the Washington Office for Tax Reasons or Other Reasons is a separate corporation. But the three principal subsidiaries are BellSouth Enterprises, Southern Bell and South Central Bell.

Senator **Metzenbaum**. Why should we assume that BellSouth will act any differently than AT&T did if the restriction is taken off you? Won't you have the same incentives to cross subsidize that AT&T had?

Mr. **Alford**. I don't believe that anybody who has gone through divestiture managing one of the pieces could not learn from that experience.

The antitrust laws, as I understand it, do not contain an irrebuttable presumption of illegal activities simply because you own an essential facility. The power companies in this country which have essential facilities are diversifying, and our companies' desire to move into related areas as well. We don't believe that simply because we have an essential facility, that there is any, in fact there isn't any antitrust doctrine that says there is an irrebuttable presumption that we will engage in illegal activity. Because we have a knife, we are not necessarily going to use it illegally.

Senator **Metzenbaum**. Well, as you undoubtedly know, last year the North American Telecommunications Association said that the competitive subsidiaries of the Bell Companies lost over $939 million in 1985.

How much did your competitive ventures lose in 1985?

Mr. **Alford**. In 1985 or—I believe—I can't give you the precise number. I believe last year we made money in our competitive endeavors. 1985 I can't recall.

We had some——

Senator **Metzenbaum**. My staff tells me you lost $95 million in your competitive ventures in 1985.

Mr. **Alford**. In 1985?

Senator **Metzenbaum**. Yes.

Mr. **Alford**. We have some startup costs associated with cellular, and we may have lost money in 1985. I believe we made money in 1986. That, however, is not published or reported to the FCC since it is not a separately publicly-owned corporation.

Senator **Metzenbaum**. My last question is, do consumers have any significant choice as to a local telephone service provider in any market in your region? Is there any competition in any part of your region for local service?

Mr. **Alford**. Yes, there are some shared tenant service providers, and there are large customers who provide their own telephone service. PBXs are essentially local—a substitute for local telephone service.

Senator **Metzenbaum**. But those PBXs are all business owned, those are not——

Mr. **Alford**. The shared tenant services is permitted in some of our jurisdictions, and I would assume if some of those are serving condominiums and residential subscribers, but I honestly can't tell you where.

Senator **Metzenbaum**. Mr. Zeglis, your prepared statement exhaustively—excuse me.

Senator Heflin, do you have any questions?

Senator **Heflin**. That's all right. I'm just listening. [Laughter.]

Senator **Metzenbaum**. Your prepared statement exhaustively reviews the principles of the AT&T case, and how the Justice Department's current recommendations violate those principals.

In your view, is there any principled intellectual justification for the Department's reversal?

Mr. **Zeglis**. Mr. Chairman, at the core of the decree, which I call long distance and manufacturing, I just can not see it. We think the Sherman Act continuing as a vital antitrust law and the existence of these bottlenecks will not justify that kind of turnaround.

In fact, the only way you can get there is to abandon some of those principals. You take manufacturing, and we have heard Mr. Rule explain how it would no longer be an antitrust concern if a company were able to leverage its control of a monopoly market here to get only 10 to 20 percent of an equipment market next door. And each company might do that, but none of them would have 100 percent of the total market because they split it among themselves.

That just repudiates what the law of the case was found to be on the arguments made by the Department.

Senator **Metzenbaum**. As I understand it, now there's great competition in long distance service.

What would happen to that competition in long distance if the Bell Companies were allowed to enter?

Mr. **Zeglis**. Well, there is a lot of competition. We number four to five hundred competitors out there right now, Mr. Chairman. We've been there before. We think that if we had local service companies again competing in a big way in the long distance market, we would fall to squabbling over the same kinds of issues that led up to the divestiture itself, the interconnection conditions, the pricing and the costing, are there discriminations, are there cross-subsidies or aren't there?

I want to make it clear, Mr. Chairman, I don't think this is an issue of who has the pure heart, morality, or who has found religion and found the antitrust laws. It is not inevitable guilt. It's inevitable, unavoidable, continuous controversy over these matters. We lived through that, and while we did, we were bogged down in every form imaginable while people tried to fix the rules for the level playing field. We waited and waited and waited, and the whole industry got drawn down, Mr. Chairman, and we don't want to go back.

Senator **Metzenbaum**. This Committee thinks that competitive forces working in the long distance industry makes sense—that's what this country is all about. It's about the free enterprise system free competition working well.

What concerns us is the ability of AT&T in the first instance in yesteryear to be able to use extraordinary power, economic power as well as technical power, to be able to monopolize the market. And now we are concerned about the ability of the seven BOCs to be able to do the same thing. And certainly they are economically strong enough to do it.

Would you care to comment on that, Mr. Zeglis?

Mr. **Zeglis**. Well, we have no quarrel, in fact we endorse completely the notion that the competitive forces at work in the long distance market bring the most consumer benefit. So the concern is that we have sacrificed at divestiture one of the most marvelous industrial enterprises ever created to let that competition roam free on a structure of the industry that excludes the local monopolies so as to avoid those disputes that dragged us down. And we think it's working and ought to be allowed to continue to work.

Senator **Metzenbaum**. Mr. Roberts, MCI has been dealing with the FCC for years on telephone issues. Am I correct about that?

Mr. **Roberts**. Yes.

Senator **Metzenbaum**. What does that long experience tell you about the FCC's ability to police the Bell Companies if the restrictions are lifted?

Mr. **Roberts**. Based on MCI's experience, there is no possible way that they could police the Bell Companies if the restrictions were lifted.

There is a history there that goes back many years that the FCC as a regulatory body simply can't police a company that has both a bottleneck control over facilities and is in a long distance business. They would not be able to adequately solice and regulate the Bell Companies should they be allowed back into long distance.

Senator **Metzenbaum**. Your prepared statement says that since divestiture, MCI's share of the long distance market has doubled, and that competition is emerging as a strong and vital force in telecommunications.

What will happen to competition in long distance if the Bell Companies are allowed to enter?

Mr. ROBERTS. Simply put, it will disappear as we know it today. It would return to the pre-divestiture mode. The industry would evolve to the point where customers and consumers would only have a single point of contact, i.e. the entity controlling the bottleneck control that was also offering long distance services.

We would return to the past.

Senator METZENBAUM. Mr. Kimmelman, long distance rates have gone down since divestiture; local rates have gone up 40 to 50 percent or more.

How have these changes affected overall telephone rates? Haven't the overall rates gone up?

Mr. KIMMELMAN. Yes, according to the Consumer Price Index for telephone service, it's up about 20 percent since the breakup.

Senator METZENBAUM. And you speak for the Consumer Federation of America.

Has the original decree and the action that was brought in the first instance, has that helped the average consumer?

Mr. KIMMELMAN. Well, I think that many people are still waiting to see the benefits that were promised to them from this whole change in our telephone system.

There were promises of information age services, very strong competition that would drive down prices of telephone service everywhere. And I think people look at their phone bills on a monthly basis and they see it really hasn't happened. And for the services that they need and they use, they are paying more today.

This is somewhat of an irony when we claim to be moving from a monopoly to a competitive environment, and you see prices go up as you enter the competitive realm.

So I think people are very concerned about what has happened. They don't feel like they have gotten what was promised to them. And I think that they are worried about major changes again because they are worried that the changes come with a lot of promises, but no real assurances and no one is accountable.

I think if you go around the country and ask people how they feel about what has happened over the last three or four years, they will say they are somewhat unhappy about it but they don't know who to blame. They don't know who is responsible. And I think at this point in time they want a little stability in their phone system.

Senator METZENBAUM. Did the Consumer Federation of America arrive at the same conclusion as has the Chairman, and that is, that although I was a strong supporter and advocate of breaking up AT&T, and I am not all certain in retrospect that it has served the public interest at all, in fact it probably has hurt the public interest.

Mr. KIMMELMAN. Well, I have made a number of strong assertions about what has happened since divestiture and I would like to clarify that.

I don't believe those things have occurred because of divestiture, because of the breakup. We have had a lot of changes in regulatory rules, and it goes on every day in the States, at the FCC. And I think that has been the problem.

So, in retrospect, looking back, our feeling is that these are very positive ideas, infusing competition into the telephone business, and we still support that. We don't believe we have gone about it the right way, and we think we need a careful review of the whole process, who pays, who benefits, and what assurance there are that the public will come out ahead as we experiment with new industry structures.

Senator METZENBAUM. What will happen to rates if restrictions on the Bell Companies are lifted?

Mr. KIMMELMAN. Well, it is difficult to predict, but as far as we can see, there is an incentive to shift more costs into local rates. From everything that we have seen from the Bell Companies, they believe local prices ought to be higher. From the difficulties that have been described by State regulators and consumer advocates who fight State rate cases, it is very difficult to prevent subsidies in the telephone system.

So our fear is that we do not have a regulatory apparatus, or a marketplace today, that can prevent local rates from going up if the restrictions are lifted.

Senator METZENBAUM. Last year, your organization found that the Bell Company shareholders had reaped a windfall of excess profits at the expense of ratepayers.

Can you tell me how excessive were those profits?

Mr. KIMMELMAN. Well, we did a comparison with the earnings of the Bell Companies, a comparison to other competitive corporations, the Business Week 1000, Forbes 500, Standard and Poor's, and other regulated utilities, not being quite sure who to compare them to, whether large competitive firms or other regulated utilities was the best comparison.

And we found that across the board, they are earning significantly more than these other corporations. In today's marketplace with inflation rates down, and interest rates down, the Bell Company's earnings went up, whereas most corporations' earnings followed the trend in the marketplace.

Senator METZENBAUM. In your written submission, I think you indicated that the current overcharge is on the order of $3 billion. Do you stand on that figure?

Mr. KIMMELMAN. Yes. It is a combination of the earnings in the marketplace, change in depreciation rules that regulators have been sympathetic to, and in addition to that, Mr. Chairman, we find now, that with the Tax Reform Bill that was passed last year by the Congress, which lowered corporate tax rates, that there are some savings there as well that the companies will reap in terms of less tax liability.

Unfortunately, unless regulators step in and reduce the expenses the companies can charge to consumers, consumers will still pay rates as if the corporations were paying higher taxes.

The figure for that is almost another billion dollars in charges that are there in the rate structure, that ought to be squeezed out to conform with the tax law.

Senator METZENBAUM. I want to thank this panel, and the Committee will stand in recess until 11:30.

[Recess.]

Senator METZENBAUM. Let me have the next panel, please. William Spratley, Consumers Counsel, Ohio Consumers Counsel, Columbus, Ohio; Kenneth Millard, Senior Vice President, Corporate Strategy, Ameritech. John Hoffman, Chairman of the Board, Comp-Tel, the Competitive Telecommunications Association, and Robert Johnson, Publisher, "Newsday", Long Island, New York.

We are happy to have you all with us. My friend, Mr. Spratley, I am happy to see you again, sir, today. You do not have to talk through a telephone system as I spoke to your recent group through a telephone system. Please proceed.

STATEMENTS OF A PANEL CONSISTING OF WILLIAM A. SPRATLEY, CONSUMERS' COUNSEL, OHIO CONSUMERS' COUNSEL, COLUMBUS, OH; KENNETH E. MILLARD, SENIOR VICE PRESIDENT, CORPORATE STRATEGY, AMERITECH, CHICAGO, IL; JOHN R. HOFFMAN, CHAIRMAN OF THE BOARD, COMPTEL [COMPETITIVE TELECOMMUNICATIONS ASSOCIATION], SHAWNEE MISSION, KS; ROBERT M. JOHNSON, PUBLISHER, NEWSDAY, LONG ISLAND, NY, VICE CHAIRMAN OF AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION, WASHINGTON, DC

Mr. SPRATLEY. I might start by saying, Mr. Chairman, we appreciate your role as a consumer advocate for Ohio consumers over the past 10 years that our office has been in existence as a State agency charged with representing the 4 million Ohio telephone consumers.

I very much appreciate this opportunity to present some policy and legal considerations for the Subcommittee's review.

In my full testimony, I have explained my opposition to the Department of Justice's proposed alteration of the modified judgment.

Based on the FCC's undermining of the carrier access charge provisions of the MFJ and the FCC's general "hands off" trend in its regulation, I also oppose AT&T's request to transfer the DOJ's line of business review responsibilities to the FCC.

Altering the decree is unjustified under any standard of review, from the strictest legal standard to the broadest public policy considerations. On the broader public policy level which has been debated here, and elsewhere, the reasons for not altering the decree are even more compelling.

The diversification of the BOCs into the prohibited lines of business will yield little or no benefit to residential consumers, but will cost consumers dearly.

This cost will be exacted in the form of cross-subsidies from the monopoly business to the competitive operations. More insidious, but less well understood, is that the line of business diversification is but one element in an integrated telecommunications framework.

Within this framework, the BOCs are working hard to accomplish their three-part agenda. This includes shifting joint costs to the residential consumers a la the subscriber line charge.

And in my testimony I point out that Judge Greene, in the divestiture case, did not intend that the access charge serve as a vehicle to shift these costs.

And in attachment two of my testimony, Mr. Chairman, are the precise numbers for the last three years in Ohio, that illustrate that the local exchange rates have gone up 39 percent, and most of that increase has flowed from the decisions of the Federal Communications Commission, the access charge being a large contributor.

Now our office has sent the attached letter to Congressman Markey opposing further increases to the access charge, and supporting the Wyden bill on the House side that would freeze that at $2 per month rather than going up to $3.50.

The second part of the telephone industry agenda is that the BOCs can use a monopoly consumer revenue base to develop and cross-subsidize new lines of business, and I have an example in my testimony, where the president of Cincinnati Bell describes this as a "crunch" on local service.

Also, the BOCs can include dramatic expense increases reflected in local rates to write off depreciation accounts for otherwise usable plant that is, quote, "technologically obsolete", unquote.

Now after consumers have been milked under regulation for all of the cost shifts, depreciation writeoffs, and cross-subsidies, the BOCs 'agenda includes escaping regulation altogether, so the final assault can be made on local service rates.

This final unfettered pricing of local service is what former chairman of the FCC Mark Fowler embraced in his "Back to the Future" proposal.

This is so radical, and so unworkable, that I find it incredible that such proposals are even on the table. However, in our State of Ohio, Ohio Bell shares this view, this radical view, in its filings at the PUCO and at the FCC.

In my opinion, local service is a natural monopoly, and there certainly is no competition that could take the place of regulation. It is in this context, and the context of my experience on the regulator side of the business, that I believe the decree should stand as it is.

If, and only if changes are to be made, I have a few recommendations. First, a significant amount of mischief can be eliminated by eliminating the relationship between the BOCs and the regional holding companies.

Secondarily, I favor the recommendation of the Massachusetts utility commission, that any consideration of lifting line of business restrictions should therefore be limited to the BOCs where it may be possible for regulators to protect against this cross-subsidization.

[The statement of Mr. Spratley follows:]

TESTIMONY OF

WILLIAM A. SPRATLEY

CONSUMERS' COUNSEL

ON BEHALF OF THE

OFFICE OF THE CONSUMERS' COUNSEL,

STATE OF OHIO

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I. INTRODUCTION

MY NAME IS WILLIAM A. SPRATLEY. FOR THE PAST TEN YEARS I HAVE SERVED AS THE OHIO CONSUMERS' COUNSEL. IN THIS POSITION, I DIRECT THE DAY-TO-DAY OPERATIONS OF THE OFFICE OF THE CONSUMERS' COUNSEL, A STATE AGENCY CHARGED BY LAW WITH THE RESPONSIBILITY OF REPRESENTING THE INTERESTS OF OHIO'S FOUR MILLION RESIDENTIAL UTILITY CONSUMERS. PRIOR TO MY APPOINTMENT AS CONSUMERS' COUNSEL, I SERVED MORE THAN TWO YEARS WITH THE PUBLIC UTILITIES COMMISSION OF OHIO (PUCO).

I VERY MUCH APPRECIATE THIS OPPORTUNITY TO PRESENT SOME POLICY AND LEGAL CONSIDERATIONS -- SHARED BY MANY CONSUMERS' COUNSELS -- ON THE RECENT PROPOSALS IN UNITED STATES DISTRICT COURT TO ALTER THE AT&T DIVESTITURE DECREE. THESE PROPOSALS INCLUDE AT&T'S MOTION, DATED DECEMBER 9, 1986, TO MODIFY THE PROCESS BY WHICH THE BELL OPERATING COMPANIES (BOCS) APPLY FOR LINE OF BUSINESS WAIVERS. CURRENTLY, THE DEPARTMENT OF JUSTICE (DOJ) SCREENS THE BOCS' REQUESTS FOR LINE OF BUSINESS WAIVERS, AND PRESENTS A RECOMMENDATION TO THE COURT. AT&T PROPOSED TRANSFERRING DOJ'S RESPONSIBILITY TO THE FEDERAL COMMUNICATIONS COMMISSION (FCC).

THE OTHER, AND MORE DRAMATIC, PROPOSALS TO THE COURT ARE THOSE OF DOJ WHICH, ON FEBRURAY 2, 1987, RECOMMENDED THAT THE MODIFICATION OF FINAL JUDGEMENT (MFJ OR DECREE) BE SIGNIFICANTLY ALTERED. DOJ RECOMMENDED THAT THE BELL OPERATING

COMPANIES AND THEIR PARENT CORPORATIONS, THE REGIONAL HOLDING COMPANIES (RHCS), BE PERMITTED TO ENGAGE IN INTEREXCHANGE SERVICES (SUBJECT TO LIMITATIONS), INFORMATION SERVICES, AND THE MANUFACTURING OF TELECOMMUNICATIONS EQUIPMENT. AS A FINAL POINT OF BACKGROUND, I AM AWARE THAT PROPOSALS HAVE BEEN CONSIDERED IN CONGRESS TO MODIFY THE DECREE LEGISLATIVELY.

WOULD IMPLEMENTATION OF THE PENDING PROPOSALS TO MODIFY THE DECREE DISCERNIBLY AFFECT LOCAL RESIDENTIAL CONSUMERS ("CONSUMERS")? UNDOUBTEDLY, YES. AND, AT THE OUTSET, I WILL ACKNOWLEDGE THAT SOME OF THE EFFECTS MAY BE POSITIVE FOR THESE CONSUMERS. THERE IS SOME POTENTIAL FOR INCREASED INNOVATION LEADING TO NEW SERVICES FOR CONSUMERS AND FOR REDUCED RATES OR TEMPERED PRICES AS A RESULT OF INCREASED COMPETITION IN THE INTEREXCHANGE AND CUSTOMER PREMISES EQUIPMENT MARKETS.

HAVING ACKNOWLEDGED THIS POTENTIAL, I WILL SPEAK TO WHAT I BELIEVE REALITY IS FOR THE RESIDENTIAL TELEPHONE CONSUMER. THE REALITY IS THAT THE TOUTED BENEFITS OF ALTERING THE DECREE LARGELY WOULD PROVE ILLUSORY FOR CONSUMERS, AND IN FACT WOULD WORK TO CONSUMERS' DETRIMENT. I FIRST WILL DISCOUNT THE ALLEGED BENEFITS AND THEN WILL EXPLAIN THE CONSUMER DETRIMENT TO ALTERING THE DECREE.

II. ALLEGED BENEFITS OF ALTERING THE DECREE

TO FOCUS ON THE ALLEGED BENEFITS, SOMETHING SHOULD BE UNDERSTOOD ABOUT CONSUMERS. THE OVERWHELMING MAJORITY OF RESIDENTIAL CONSUMERS SUBSCRIBE TO WHAT HAS BEEN CHARACTERIZED AS PLAIN OLD TELEPHONE SERVICE ("POTS"). POTS IS TYPIFIED BY A HEAVY, IF NOT EXCLUSIVE, RELIANCE ON VOICE (AS OPPOSED TO DATA) TRANSMISSION, AND DOES NOT NECESSARILY INCLUDE ALL THE VARIOUS "BELLS AND WHISTLES" AVAILABLE FROM MANY BOCS.

THUS, POTENTIAL BENEFITS FROM ADVANCES IN TECHNOLOGY AND SERVICES DO NOT RESPOND (BUT INSTEAD OVER-RESPOND) TO THE NEEDS OF CONSUMERS TODAY AND FOR THE FORESEEABLE FUTURE. THIS IS NOT TO SAY THAT CONSUMERS EXPECT THEIR TELEPHONE SERVICE TO REMAIN STATIC, BUT THEIR RELATIVELY UNSOPHISTICATED SERVICE NEEDS ALWAYS WILL LAG GREATLY THE HIGH-TECH NEEDS OF THE MAJOR BUSINESS CONSUMERS.

AS FOR THE ALLEGED BENEFITS OF REDUCED OR TEMPERED RATES, I CERTAINLY WOULD LIKE TO SEE THAT. BUT I DOUBT CONSUMERS WOULD SEE IT IF THE DECREE IS ALTERED. WITH RESPECT TO CUSTOMER PREMISES EQUIPMENT, THE POTS NEEDS OF CONSUMERS CURRENTLY ARE ADDRESSED IN THE MARKET BY MANY COMPETITORS. I DOUBT THAT THE BOCS CAN ADD MUCH IN THE WAY OF BENEFITING CONSUMERS ECONOMICALLY IN THIS REGARD.

SIMILARLY, I CANNOT JUMP ON THE BANDWAGON FOR THE ALLEGED BENEFITS OF ALLOWING THE BOCS TO COMPETE IN THE INTEREXCHANGE MARKETS. CONTRARY TO THE CUSTOMER PREMISES EQUIPMENT MARKET (WHICH IS TYPIFIED BY FAIRLY VIGOROUS COMPETITION), I DOUBT THAT THE INTEREXCHANGE MARKET CAN SUSTAIN SUCH COMPETITION. I AM SUGGESTING THAT THE GREAT EXPERIMENT IN COMPETITION THAT WAS THE AT&T DIVESTITURE MAY LEAVE US WITH LITTLE MORE (AND PERHAPS LESS) THAN A DUOPOLY -- AT&T AND POSSIBLY THE CONSOLIDATED REMENANT OF SEVERAL OF THE LARGER COMPETITORS. (ALTHOUGH, SOME COMPETITORS MAY FIND SUCH LIMITED NICHES AS SERVING A FEW MAJOR BUSINESS CONSUMERS OR REGIONAL MARKETS.) ADDING THE BOCS TO THIS EQUATION MAY AMOUNT TO AN OLIGOPOLY, BUT NONE OF THESE SCENARIOS WILL PROVIDE THE BENEFITS OF PRICE COMPETITION THAT WOULD MAKE A DIFFERENCE TO THE NATION'S RESIDENTIAL CONSUMERS.

AND MAKE NO MISTAKE ABOUT IT, TEMPERED OR REDUCED PRICES FOR LONG DISTANCE SERVICE WOULD BE THE MAJOR BENEFIT THAT A COMPETITIVE MARKET COULD BRING TO RESIDENTIAL CONSUMERS. I JUST DO NOT BELIEVE IT WILL HAPPEN, WITH OR WITHOUT THE BOCS.

ALREADY, THE EXTRAORDINARY COST OF DUPLICATING AT&T'S LONG DISTANCE NETWORK IS TAKING ITS TOLL ON WOULD-BE COMPETITORS, AS DEMONSTRATED BY THE INDUSTRY SHAKE-OUT AND MERGER OF SOME MAJOR PLAYERS. COMPTEL (THE ASSOCIATION OF AT&T'S COMPETITORS) HAS EVEN TAKEN TO OPPOSING FURTHER FCC-ORDERED CARRIER ACCESS CHARGE REDUCTIONS THAT WOULD REDUCE COSTS FOR ITS OWN MEMBERSHIP AND AT&T, PRESUMABLY BECAUSE THESE CARRIERS NO LONGER (OR NOT MUCH LONGER) HAVE THE ECONOMIC WHEREWITHAL TO MEET OR BEAT AT&T'S PRICES.

THIS BRINGS US TO THE MOST SIGNIFICANT REASON THAT INTERSTATE LONG DISTANCE RATES HAVE DECREASED IN RECENT TIMES

SINCE DIVESTITURE -- THE FCC'S RATE RESTRUCTURING SCHEME. EVEN IF AT&T HAD NO COMPETITORS AND THE BOCS NEVER FULLY ENTER THE INTEREXCHANGE BUSINESS, AT&T'S RATES WOULD DECREASE (AND WILL CONTINUE TO DECREASE) BECAUSE THE FCC HAS IMPLEMENTED ITS SCHEME TO SHIFT BILLIONS OF DOLLARS FROM LONG DISTANCE RATES ONTO LOCAL RATES, VIA THE SUBSCRIBER LINE CHARGE AND INCREASING THE ALLOCATIONS TO THE STATE JURISDICTIONS. THESE LONG DISTANCE PRICE BENEFITS ARE MORE IMAGINED THAN REAL FOR THE GREAT MANY CONSUMERS BECAUSE THEY DO NOT MAKE ENOUGH LONG DISTANCE CALLS TO OFFSET THEIR HIGHER LOCAL RATES.

NO ONE SHOULD BELIEVE THAT THESE LONG DISTANCE RATE REDUCTIONS REFLECT THE FORCE OF COMPETITION, BECAUSE THEY DO NOT. THEY REFLECT THE FORCE OF AN IDEOLOGICALLY EXTREME FEDERAL AGENCY, THE FCC.

IN SUM, I EXPECT THAT THE NEAR COMPLETION OF THE FCC'S RATE RESTRUCTURING AND THE EXTRAORDINARY COST OF DUPLICATING AT&T'S INTERSTATE NETWORK PROBABLY FORECLOSE SIGNIFICANT PRICE BENEFITS IN THE FUTURE, WITH OR WITHOUT THE BOCS. IF AT&T'S BUSINESS IS A NATURAL MONOPOLY AFTER ALL -- WHICH I BELIEVE IT IS, THEN PRICES SHOULD BE CHECKED BY REGULATION, AND NOT VAIN COMPETITION.

FURTHERMORE, I DO NOT EXPECT THAT THE BOCS WOULD BRING COMPETITION TO THE SERVICE AREAS (LARGELY RURAL) OF THOSE CONSUMERS WHO CURRENTLY HAVE NO ALTERNATIVE TO AT&T'S SERVICE. THE HISTORY OF THE BOCS IS ONE OF SERVICE TO THE MOST ECONOMICALLY ADVANTAGEOUS AREAS (THE MAJOR CITIES), AND I SEE NOTHING THAT WOULD CHANGE THAT PHILOSOPHY IF THE DECREE WERE ALTERED.

FINALLY, AS PRICE COMPETITION RECEDES THERE HAS BEEN A MARKED EFFORT BY CARRIERS TO DIFFERENTIATE THEIR SERVICE ON QUALITY CONSIDERATIONS. WHILE AN ULTRA-HIGH QUALITY NETWORK MAY BE ESSENTIAL TO A MAJOR BUSINESS ENGAGED IN DATA TRANSMISSION, SUCH SUPER QUALITY IS AN OVER-RESPONSE TO WHAT THE PLAIN OLD TELEPHONE SERVICE CUSTOMER NEEDS TO CALL AUNT MARTHA AND UNCLE JACK. IT IS PRICE -- AND NOT THE ABILITY TO HEAR A PIN DROP VIA LONG DISTANCE -- THAT MOST SERVES THE RESIDENTIAL CONSUMERS' INTERESTS.

III. THE DETRIMENTAL EFFECT OF ALTERING THE DECREE

UP TO THIS POINT IN MY TESTIMONY IT MAY APPEAR THAT I BELIEVE ALTERING THE DECREE AT MOST WOULD BE A "WASH" FOR CONSUMERS, NEITHER IMPROVING NOR WORSENING THEIR LOT. NOTHING COULD BE FARTHER FROM THE TRUTH. FOR THE LACK OF REAL BENEFITS WHICH I DISCUSSED WOULD BE ATTENDED BY SOME SERIOUS PROBLEMS FOR CONSUMERS.

TO BEGIN WHERE I LEFT OFF IN THE PREVIOUS SECTION, THE INTRODUCTION OF THE BOCS INTO THE INTEREXCHANGE BUSINESS WOULD FUEL THE EFFORTS OF THE BOCS AND OTHERS TO DEREGULATE THE INTEREXCHANGE BUSINESS ALTOGETHER (IF BY THEN SUCH EFFORTS HAVE NOT ALREADY SUCCEEDED). THIS TOTAL DEREGULATION ALREADY IS ON THE TABLE IN THE FCC'S CC DOCKET NO. 86-421, WHICH IS PENDING A DECISION AFTER THE RECENT COMPLETION OF THE COMMENT CYCLE.

ALLOWING THE BOCS INTO THE INTEREXCHANGE MARKET WOULD FURTHER THE CAUSE OF DEREGULATION BECAUSE DEREGULATION IS (OR SHOULD BE) PREMISED ON THE IDEA (FALSE THOUGH IT IS HERE) THAT THE MARKET IS COMPETITIVE. ONCE DEREGULATED, AT&T AND THE BOCS WOULD BE FREE TO PRICE THEIR LONG DISTANCE RATES AS THEY PLEASED. I CAN ALL BUT GUARANTEE THAT THE INVISIBLE HAND OF THIS SUPPOSED FREE MARKET WOULD PROVIDE A REAL SLAP IN THE FACE OF RESIDENTIAL CONSUMERS ACCUSTOMED TO AVERAGED AND OTHERWISE REGULATED RATES.

IN FACT, THE PROMISE OF INCREASED RATES UNDER DEREGULATION IS ALREADY UNFOLDING. I REFER TO MCI'S RECOMMENDATION, IN THE AFOREMENTIONED FCC CC DOCKET 86-421, THAT AT&T BE DEREGULATED. COMING FROM MCI, THIS ONLY IS COMPREHENSIBLE UNDER THE SUPPOSITION THAT AT&T WILL INCREASE, NOT DECREASE, ITS RATES ONCE DEREGULATED.

BUT THE INDUSTRY'S DESIGNS ARE MORE INSIDIOUS, ALBEIT HARD TO FOLLOW, FOR CONSUMERS THAN JUST DEREGULATING A NATURAL MONOPOLY (OR OLIGOPOLY) SERVICE. MCI CAN EXPECT AT&T (OR A BOC) TO MAINTAIN RELATIVELY HIGHER RATES UNDER DEREGULATION BECAUSE IT KNOWS THAT UNDER REGULATION THE FCC WILL ORDER RATE REDUCTIONS FOR AT&T AS THE SUBSCRIBER LINE CHARGE (SLC) IS INCREASED. THESE RATE REDUCTIONS CONSTITUTE THE FCC'S AVOWED

COMMITMENT TO "OFFSET" THE SLC INCREASES WITH LONG DISTANCE RATE REDUCTIONS -- WHICH IS A LINCHPIN IN THE FCC'S JUSTIFICATION OF THE SUBSCRIBER LINE CHARGE.

NOW FOR SOME SLEIGHT OF HAND. AS THE FCC MOVES TOWARD DEREGULATING THE LONG DISTANCE BUSINESS, IT CONCOMITANTLY WILL RELINQUISH CONTROL OVER WHEN AND TO WHAT EXTENT (IF AT ALL) THE SLC INCREASES ARE OFFSET BY LONG DISTANCE RATE REDUCTIONS. THUS, THE "OFFSET" CONCEPT PROBABLY WILL PROVE ILLUSORY OVER THE NEXT FEW YEARS, AFTER SERVING ITS PUBLIC RELATIONS ROLE FOR SLC INCREASES. CONSUMERS WILL END UP PAYING THE MONTHLY SLC -- $3.50 BY 1989 -- PLUS HIGHER LONG DISTANCE RATES.

PERHAPS MOST DISTRESSING IN THIS UNHAPPY TURN OF EVENTS HAS BEEN THE THE BOCS' DEMONSTRATED PROPENSITY TO UNDO MAJOR CONSUMER PROTECTIONS OF THE DECREE. AS JUDGE GREENE MADE CLEAR, THE ACCESS CHARGE SYSTEM WAS NOT INTENDED AS A VEHICLE FOR SHIFTING COSTS TO LOCAL RATES. TO THE CONTRARY, JUDGE GREENE EXPLAINED THAT IT WAS INTENDED AS A MEANS TO PROTECT LOCAL RATE LEVELS:

> IT MAY APPROPRIATELY BE GENERALIZED THAT LOCAL TELEPHONE SERVICE IS RELATIVELY MORE RELIED UPON BY INDIVIDUALS AND THAT LONG DISTANCE IS MORE BUSINESS-ORIENTED. IF THE OBJECTIVE OF TELEPHONE SERVICE AVAILABLE AT REASONABLE RATES TO ALL IS NOT TO BE JEOPARDIZED, IT IS THEREFORE MOST IMPORTANT THAT LOCAL RATES NOT BE BURDENED BY UNNECESSARY INCREASES. AS THE COURT REPEATEDLY POINTED OUT IN ITS AUGUST 11, 1982, OPINION (ESPECIALLY IN CONNECTION
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> WITH THE DISCUSSION OF THE ACCESS CHARGE ISSUE (SEE INFRA)) THERE IS NO LEGITIMATE BASIS FOR USING THE REORGANIZAITON OF THE BELL SYSTEM AS A MEANS FOR UNDERMINING THE UNIVERSAL SERVICE OBJECTIVE OR AS AN EXCUSE FOR RAISING LOCAL RATES.

> THE COURT HAS THEREFORE NOTED WITH CONSIDERABLE SURPRISE AND SOME DISMAY THAT THE FEDERAL COMMUNICATIONS COMMISSION, FAR FROM USING THE ACCESS CHARGE TOOL AS A MEANS FOR EASING THE BURDENS ON THE USERS OF LOCAL TELEPHONE SERVICE, HAS OPTED INSTEAD, IN A MAJOR DECISION ISSUED SINCE THE COURT'S APPROVAL OF THE CONSENT DECREE, TO SADDLE THE LOCAL SUBSCRIBERS WITH THE ACCESS COSTS OF INTEREXCHANGE CARRIERS. CURIOUSLY, ALTHOUGH THE FCC CITES THAT DECREE AND OSTENSIBLY REGARDS ITS DECISION AS ASSISTING IN ITS IMPLEMENTATION, THE AGENCY'S ACTION RUNS DIRECTLY COUNTER TO ONE OF THE DECREE'S PRINCIPAL ASSUMPTIONS AND PURPOSES -- THAT THE FOSTERING OF COMPETITION IN THE TELECOMMUNICATIONS FIELD NEED NOT AND SHOULD NOT BE THE CAUSE OF INCREASES IN LOCAL TELEPHONE RATES.

THE COMMISSION'S ACTION IS UNDERGIRDED BY TWO PREMISES: FIRST, THAT LONG-DISTANCE REVENUES HAVE BEEN SUBSIDIZING LOCAL RATES, AND SECOND, THAT THE BURDEN OF THE OPERATING COMPANIES' NEW REVENUE NEEDS TO COMPENSATE FOR THE LOST "SUBSIDY" MUST FOR REASONS OF POLICY AND ECONOMICS BE BORNE PRIMARILY BY THE RESIDENTIAL SUBSCRIBERS. THERE IS NO BASIS FOR EITHER OF THESE PREMISES.

IN THE FIRST PLACE, IT IS NOT AT ALL CLEAR THAT THE SUBSIDY ASSUMED BY THE FCC HAS EVER EXISTED. IN ITS EXTENDED OVERSIGHT OF AT&T, AND IN INVESTIGATIONS EXTENDING OVER MANY YEARS, THE COMMISSION WAS NEVER ABLE TO DETERMINE WHETHER, IN FACT, LOCAL RATES HAD BEEN SUBSIDIZED BY

LONG DISTANCE RATES. IN SPITE OF THAT RECORD, THE FCC IN ITS DECEMBER 1982 DECISION SIMPLY IGNORED THE SUBSIDY PROBLEM AND WENT ON TO DECIDE THAT, SUBSIDY OR NOT, THE TELECOMMUNICATIONS SYSTEM'S FIXED COSTS (SEE NOTE 37 SUPRA) SHALL ULTIMATELY BE BORNE BY THE INDIVIDUAL SUBSCRIBERS. THESE

SUBSCRIBERS, MOREOVER, WILL BEAR THIS BURDEN REGARDLESS OF HOW FREQUENTLY, IF AT ALL, THEY MAKE USE OF THEIR INSTRUMENTS FOR LONG DISTANCE CALLS.

SECOND, EVEN IF IT BE ASSUMED THAT THERE WAS SUCH A SUBSIDY, IT IS QUITE CLEAR THAT MEANS OTHER THAN RATE INCREASES FOR

RESIDENTIAL SUBSCRIBERS ARE AVAILABLE TO MAKE UP FOR THE LOST FUNDS. IT WAS CONSIDERED BY EVERYONE CONCERNED, INCLUDING THIS COURT WHEN IT APPROVED THE DECREE, THAT IF IT WERE EVER DETERMINED THAT AT&T'S INTERSTATE RATES HAD, IN FACT, BEEN SUBSIDIZING LOCAL SERVICE, COMPLIANCE WITH THE LAW'S UNIVERSAL SERVICE OBJECTIVE COULD AND WOULD BE ACHIEVED BY REPLACING THE SUBSIDY WITH ACCESS CHARGES LEVIED ON THE INTEREXCHANGE CARRIERS. THUS, THE COURT STATED IN THE AUGUST 11, 1982, OPINION THAT THE DECREE

> LEAVE[S] STATE AND FEDERAL REGULATORS WITH A MECHANISM -- ACCESS CHARGES -- BY WHICH TO REQUIRE A SUBSIDY FROM INTERCITY SERVICE TO LOCAL SERVICE. BY MEANS OF THESE ACCESS CHARGES, THE
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> REGULATOR WOULD BE FREE TO MAINTAIN LOCAL RATES AT CURRENT LEVELS OR THEY COULD SO SET THE CHARGES AS TO INCREASE OR DECREASE LOCAL RATES (EMPHASIS ADDED).

THE COURT AGAIN EMPHASIZED IN THE CONCLUDING PART OF ITS OPINION THAT THE OPERATING COMPANIES WOULD BE PERMITTED,

UNDER THE SUPERVISION OF STATE AND FEDERAL REGULATORS, "TO LEVY ACCESS CHARGES UPON LONG DISTANCE CARRIERS" FOR USE AS A SUBSIDY FOR LOCAL TELEPHONE RATES (EMPHASIS ADDED). 552 F.SUPP. AT 224 N. 376.

DURING THE PUBLIC INTEREST PROCEEDING WHICH PRECEDED THE ENTRY OF THE DECREE NO ONE -- INCLUDING THE FCC -- SUGGESTED THAT ACCESS CHARGES SHOULD BE SHIFTED FROM THE INTEREXCHANGE CARRIERS (WHICH REQUIRE ACCESS TO THE LOCAL NETWORKS TO ENABLE THEM TO DO BUSINESS) TO THE LOCAL USERS (WHO ARE ALREADY PAYING FOR THOSE LOCAL NETWORKS THROUGH THEIR TELEPHONE RATES). IN THE CONTEXT OF THE OBJECTIVE OF PRESCRIBING LOW LOCAL TELEPHONE RATES AND THE GOAL OF UNIVERSAL SERVICE THAT WOULD HAVE MADE NO SENSE. YET, THAT IS PRECISELY WHAT THE COMMISSION HAS NOW DECIDED TO DO.

THE COURT HAS CONSIDERED IT NECESSARY TO COMMENT ON THIS FCC ACTION BECAUSE THAT ACTION SIGNIFICANTLY IMPACTS ON THE COURT'S OWN RESPONSIBILITIES IN THREE RESPECTS: (1) BY ITS APPROVAL OF THE DECREE, THE COURT SOUGHT TO ESTABLISH MACHINERY FOR RATEPAYER PROTECTION THAT IS BEING JETTISONED BY THE

FCC; (2) THE FCC ACTION APPEARS TO BE AN EFFORT UNJUSTIFIABLY TO ASSIGN TO THE DIVESTITURE RESPONSIBILITY FOR A REALLOCATION OF CHARGES WHICH THE COMMISSION HAS DECIDED UPON FOR ITS OWN REASONS; AND (3) THE COURT IS MAKING A CONSIDERABLE EFFORT HEREIN TO PROTECT THE

> LOCAL RATES OF TELEPHONE SUBSCRIBERS, AND IT FINDS IT UNFORTUNATE THAT THE COMMISSION'S DECISION WILL TEND TO DEFEAT THAT OBJECTIVE.

UNITED STATES V. AT&T, 569 F. SUPP. 990, 997-1000 (D.D.C. 1983) (FOOTNOTES OMITTED) (EMPHASIS ADDED).

IT IS FOR THESE REASONS AND THOSE EXPRESSED IN THE ATTACHED LETTER TO UNITED STATE REPRESENTATIVE EDWARD MARKEY THAT THE OFFICE OF THE CONSUMERS' COUNSEL SUPPORTS REPRESENTATIVE WYDEN'S BILL (H.R. 782) TO FREEZE THE SLC AT ITS CURRENT LEVEL OF $2.00 PER MONTH PER LINE. ALREADY, THE FCC BEARS MUCH OF THE BLAME FOR THE 39 PERCENT AVERAGE INCREASE IN LOCAL SERVICE RATES FOR OHIO CONSUMERS SINCE DIVESTITURE. (SEE ATTACHED CHART)

THE BOCS' MISCHIEFS ARE NOT LIMITED TO THE INTEREXCHANGE PROVISIONS OF THE DECREE. THE SHORT HISTORY OF THE DIVESTED BOCS ARGUES GENERALLY AGAINST ALTERING ANY OF THE DECREE'S BUSINESS RESTRICTIONS. FOR EXAMPLE, JUDGE GREENE INTENDED THAT THE "YELLOW PAGES" DIRECTORY ADVERTISING PROFITS WOULD REMAIN WITH THE DIVESTED BOCS TO PROVIDE A CONTRIBUTION TO LOCAL RATES. INSTEAD, VARIOUS OF THE BOCS AND RHCS HAVE ESTABLISHED UNREGULATED SUBSIDIARIES FOR THE YELLOW PAGES BUSINESS, WHICH ARRANGEMENT, AMONG OTHER THINGS, MAKES IT DIFFICULT TO REGULATE THE PROPER CONTRIBUTION LEVEL AND ULTIMATELY MAY UNDO THE CONTRIBUTION ALTOGETHER.

ON THE TOPIC OF CONTRIBUTION GENERALLY, THE TREND SINCE DIVESTITURE HAS BEEN AWAY FROM THIS TRADITION. FOR EXAMPLE, IN ITS DOCKET FOR DEVELOPING REGULATED VERSUS UNREGULATED COST SEPARATION STANDARDS, THE FCC RECENTLY REJECTED THE CONTRIBUTION CONCEPT:

> UNDER THE APPROACH THAT WE ARE DEVELOPING HERE, THE CARRIER THAT EARNS LARGE PROFITS FROM A NONREGULATED ACTIVITY WILL NOT BE REQUIRED TO SHARE SUCH PROFITS WITH USERS OF REGULATED SERVICES. SOME STATE COMMISSIONS MAY TAKE A DIFFERENT APPRAOCH.

REPORT AND ORDER, CC DOCKET NO. 86-111, PARA. 109 N.215 (RELEASED FEBRUARY 6, 1987).

THE PUCO RECENTLY REJECTED THE CONTRIBUTION CONCEPT WITH RESPECT TO OHIO BELL AND OTHER TELEPHONE COMPANIES' DEREGULATED INSIDE WIRE BUSINESS:

> WHAT OCC HAS PROPOSED HERE IS NOT ONLY UNFAIR TO THE TELEPHONE COMPANIES, BUT, AS UNITED POINTS OUT, MAY HAVE THE EFFECT OF NEGATING DEREGULATION AND DISCOURAGING TELEPHONE COMPANIES FROM REMAINING IN THE INSIDE WIRING BUSINESS. REHEARING SHALL THEREFORE, BE DENIED.

ENTRY ON REHEARING AT PARA. 11, CASE NO. 86-927-TP-COI (FEBRUARY 10, 1987). THUS, IT SEEMS PRETTY CLEAR THAT ALLOWING THE BOCS INTO NOW FORBIDDEN LINES OF BUSINESS WILL NOT BRING THE ONCE TRADITIONAL CONTRIBUTION THAT ARGUABLY ONCE JUSTIFIED SOME DIVERSIFICATION.

WHAT THIS WILL BRING IS CROSS-SUBSIDIZATION AND AN ATTENDANT OVERSIGHT NIGHTMARE FOR REGULATORS. OF COURSE, REGULATORY OVERSIGHT PARTICULARLY IS DIFFICULT BECAUSE OF THE RHCS' RENOWNED RELUCTANCE TO SHARE INFORMATION WITH REGULATORS. IN THIS REGARD, I HAVE ATTACHED TWO EXAMPLES, FROM OHIO BELL'S MOST RECENT RATE CASE, OF OHIO BELL'S DISCOVERY DEFLECTION TACTICS. OHIO BELL'S NONDISCLOSURE TACTICS ARE SUCH THAT IT EVEN CLAIMED MY OFFICE'S USE OF THE WORD "AMERITECH" WAS "VAGUE AND INDEFINITE," AND IT HAD "NO SUCH INFORMATION" ABOUT AMERITECH.

I ALSO WILL RECOUNT A RECENT EXAMPLE OF OHIO BELL'S WILLINGNESS TO MANIPULATE THE EFFECT OF THE DECREE. UNBEKNOWNST TO MY OFFICE AND THE PUCO, OHIO BELL -- MORE THAN TWO YEARS AFTER DIVESTITURE -- WAS STILL COLLECTING A SECURITY DEPOSIT FROM CUSTOMERS BASED UPON PRE-DIVESTITURE INTERSTATE AND INTERLATA LONG DISTANCE CALLING THAT OHIO BELL WAS PROHIBITED FROM PROVIDING BY THE MFJ. THE EFFECT WAS TO DOUBLE (TO $65) WHAT THE TYPICAL DEPOSIT SHOULD HAVE BEEN. OHIO BELL SIGNED AN AGREEMENT TO REFORM THIS PRACTICE ONLY AFTER MY OFFICE DISCOVERED THE ABUSE AND FILED A COMPLAINT AT THE PUCO.

CONSUMERS' COUNSEL V. OHIO BELL, CASE NO. 86-839-TP-CSS.

I CAN TELL YOU THAT CINCINNATI BELL, WHICH IS NOT SUBJECT TO THE DECREE RESTRICTIONS AND HAS DIVERSIFIED, EVIDENCES THESE CONCERNS. IN CINCINNATI BELL'S MOST RECENT RATE CASE, MY OFFICE OBTAINED (THROUGH DISCOVERY) A DOCUMENT IN WHICH BELL'S PRESIDENT WAS QUOTED AS FOLLOWS:

> IN THE SHORT RUN, CBT MIGHT FEEL THE CRUNCH AS THE SUBSIDIARIES GROW. IN MANY CASES, SOME OF CBT'S BEST PEOPLE ARE MOVING INTO POSITIONS IN THE NEW ENTITIES. "IT'S GOING TO HAPPEN BECAUSE THE TELEPHONE COMPANY HAS THE SIZE AND DIVERSITY TO OFFER THE BEST DEVELOPMENT FOR MANAGERS." [PRESIDENT] SULLIVAN POINTED OUT. "BUT FORTUNATELY WE HAVE A STRONG CADRE OF 'BEST' PEOPLE."

SOLLER, IT'S ALL IN THE FAMILY, CINCINNATI BELL MAGAZINE, JUNE 1984, AT 7 (EMPHASIS ADDED). IN ITS DECISION IN THE CASE, THE PUCO EXPRESSED ITS "CONCERN[] ABOUT THE CONTINUING NATURE OF THE TRANSFER OF EMPLOYEES AND THE USE OF TECHNICAL STAFF AND INFORMATION BY THE [CBI] SUBSIDIARIES." CINCINNATI BELL TELEPHONE COMPANY, CASE NO. 84-1272-TP-AIR, ORDER AT 23 (OCTOBER 29, 1985).

THIS IS MORE THAN ENOUGH OF A REGULATORY PROBLEM WHERE THE COMPANY (CINCINNATI BELL) SERVES 500,000 OF OHIO'S 4 MILLION RESIDENTIAL CONSUMERS. UNLEASHING OHIO BELL FROM THE DECREE RESTRICTIONS WOULD VISIT THIS "CRUNCH" ON 2.5 MILLION OF OHIO'S 4 MILLION CONSUMERS.

AS IF MATTERS ARE NOT BAD ENOUGH UNDER REGULATION, WHAT IS REALLY FRIGHTENING IS THAT OHIO BELL HAS RECOMMENDED (IN PUCO CASE NO. 86-1144-TP-COI) COMPLETE DEREGULATION OF ALL ITS SERVICES, EXCEPT FOR LOCAL MEASURED SERVICE. COMCOMITANTLY, OHIO BELL (PER AMERITECH) HAS ASKED THE FCC (IN CC DOCKET 86-421) TO PREEMPT THE STATES IF THE FCC DEREGULATES THE BOCS AND OTHER COMPANIES. THUS, OHIO BELL IS WORKING TOWARD THE DAY WHEN IT CAN STRIP CONSUMERS OF VIRTUALLY ALL REGULATORY PROTECTION. THAT WOULD BE A SAD DAY, INDEED.

AS ONE MORE EXAMPLE OF THE CROSS-SUBSIDY PROBLEM, I WILL RELATE THE RECENT REVELATIONS OF CHESAPEAKE & POTOMAC BELL TELEPHONE COMPANY'S INTERIM COST SEPARATION PROCEDURES FOR DEREGULATED INSIDE WIRING. THE FOLLOWING QUOTATION THEREFROM REFLECTS THE CLASSIC MONOPOLY ABUSE BY CROSS-SUBSIDY PROBLEM ATTENDANT TO LINE OF BUSINESS DIVERSIFICATION:

> 7.0 ALLOCATION OF EXPENSES
>
> HERE ARE SEVERAL SCENARIOS WHICH MAY ASSIST YOU IN CORRECTLY CHARGING INSIDE WIRE EXPENSES.
>
> 7.1 INSIDE WIRE VS OTHER REGULATED SERVICES
>
> A. AN ACCOUNT EXECUTIVE VISITS A CUSTOMER. DURING THE VISIT, BOTH REGULATED AND INSIDE WIRE SERVICES ARE DISCUSSED. NO TIME OR EXPENSE SHALL BE CHARGED TO INSIDE WIRE. (ORIGINAL EMPHASIS)
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> B. THE SAME SCENARIO AS ABOVE (7.1.A), WITH THE EXCEPTION THAT IN A FOLLOW-UP VISIT THE CUSTOMER OPTS TO CONTRACT FOR INSIDE WIRE. THE ACCOUNT EXECUTIVE SHALL MAKE A "BEST ESTIMATE" OF THE AMOUNT OF TIME ACTUALLY SPENT ON INSIDE WIRE AND CHARGE THE KCO ACCORDINGLY IF IT EXCEEDS ONE HALF OF A DAY. (EMPHASIS ADDED)

IV. CONCLUSION

IN THIS TESTIMONY, I HAVE EXPLAINED MY OPPOSITION TO DOJ'S PROPOSED ALTERATION OF THE MFJ. BASED UPON THE FCC'S AFOREMENTIONED UNDERMINING OF THE CARRIER ACCESS CHARGE PROVISIONS OF THE MFJ AND THE FCC'S GENERAL "HANDS-OFF" TREND IN ITS REGULATION, I ALSO OPPOSE AT&T'S REQUEST TO TRANSFER DOJ'S LINE OF BUSINESS REVIEW RESPONSIBILITIES TO THE FCC.

AS I HAVE TESTIFIED, ALTERING THE DECREE IS UNJUSTIFIED UNDER ANY STANDARD OF REVIEW, FROM THE STRICTEST LEGAL STANDARD

CONSIDERATIONS TO THE BROADEST PUBLIC POLICY CONSIDERATIONS. WITH RESPECT TO THE LEGAL STANDARD, DOJ PREMISED ITS PROPOSALS ON THE FOLLOWING:

> THUS, A RESTRICTION WILL BE REMOVED UPON A SHOWING THAT THERE IS NO SUBSTANTIAL POSSIBILITY THAT AN OPERATING COMPANY COULD USE ITS MONOPOLY POWER TO IMPEDE COMPETITION IN THE RELEVANT MARKET. 552 F. SUPP. 131, 195 (D.D.C. 1982).

DOJ REPORT AND RECOMMENDATIONS AT 45. I HOPE I HAVE MADE CLEAR TODAY MY VIEW THAT SUCH BOC ABUSES ARE NOT MERELY A "SUBSTANTIAL POSSIBILITY," BUT ARE A CERTAINTY.

ON THE BROADER PUBLIC POLICY LEVEL WHICH HAS BEEN DEBATED HERE AND ELSEWHERE, THE REASONS FOR NOT ALTERING THE DECREE ARE EVEN MORE COMPELLING. THE DIVERSIFICATION OF THE BOCS INTO THE PROHIBITED LINES OF BUSINESS WILL YIELD LITTLE OR NO BENEFITS TO RESIDENTIAL CONSUMERS, BUT WILL COST CONSUMERS DEARLY. THIS COST WILL BE EXACTED IN THE FORM OF CROSS-SUBSIDIES FROM THE MONOPOLY BUSINESS TO THE COMPETITIVE OPERATIONS.

MORE INSIDIOUS BUT LESS WELL UNDERSTOOD IS THAT LINE OF BUSINESS DIVERSIFICATION IS BUT ONE ELEMENT IN AN INTEGRATED TELECOMMUNICATIONS FRAMEWORK. WITHIN THIS FRAMEWORK THE BOCS ARE WORKING HARD TO ACCOMPLISH THEIR AGENDA. THIS INCLUDES SHIFTING JOINT COSTS TO THE RESIDENTIAL CONSUMERS, A LA THE SUBSCRIBER LINE CHARGE. IT INCLUDES USING THE MONOPOLY CONSUMER REVENUE BASE TO DEVELOP AND OTHERWISE CROSS-SUBSIDIZE NEW LINES OF BUSINESS, A LA CINCINNATI BELL'S "CRUNCH" ON LOCAL SERVICE. IT INCLUDES DRAMATIC EXPENSE INCREASES REFLECTED IN LOCAL RATES TO WRITE-OFF DEPRECIATION ACCOUNTS FOR OTHERWISE USABLE PLANT THAT IS "TECHNOLOGICALLY OBSOLETE."

FINALLY, AFTER CONSUMERS HAVE BEEN MILKED UNDER REGULATION FOR ALL THE COST SHIFTS, DEPRECIATION WRITE-OFFS, AND CROSS-SUBSIDIES, THE BOCS' AGENDA INCLUDES ESCAPING REGULATION ALTOGETHER SO THE FINAL ASSALT CAN BE MADE ON LOCAL SERVICE RATES. THIS FINAL UNFETTERED PRICING OF LOCAL SERVICE IS WHAT THE FORMER CHARIMAN OF THE FCC, MARK FOWLER, EMBRACED

IN HIS BACK TO THE FUTURE PROPOSAL. THIS IS SO RADICAL AND UNWORKABLE I FIND IT INCREDIBLE THAT SUCH PROPOSALS EVEN ARE ON THE TABLE. LOCAL SERVICE IS A NATURAL MONOPOLY, AND THERE CERTAINLY IS NO COMPETITION THAT COULD TAKE THE PLACE OF REGULATION.

IT IS IN THIS CONTEXT AND THE CONTEXT OF MY TWELVE PLUS YEARS ON THE REGULATOR SIDE OF THE BUSINESS THAT I SAY THE DECREE SHOULD STAND AS IT IS. IF, AND ONLY IF, CHANGES ARE TO BE MADE, THEN I HAVE SOME RECOMMENDATIONS.

FIRST, A SIGNIFICANT AMOUNT OF MISCHIEF CAN BE ELIMINATED BY ELIMINATING THE RELATIONSHIP BETWEEN THE BOCS AND THE RHCS -- A SECOND DIVESTITURE. THIS WAS RECOMMENDED BY THE NATIONAL ASSOCIATION OF WHICH MY OFFICE IS A MEMBER, THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES (NASUCA) IN ITS RECENT COMMENTS BEFORE JUDGE GREENE. A SECOND DIVESTITURE ALSO HAS BEEN RECOMMENDED BY CHAIRPERSONS OF THE MASSACHUSETTS AND VERMONT UTILITIES COMMISSIONS. LEVY AND MCCARREN, FREE THE LOCAL TELEPHONE COMPANIES, 118 PUBLIC UTILITIES FORTNIGHTLY 13, 15 (JULY 10, 1986).

SECONDARILY, I ALSO FAVOR THE RECOMMENDATION OF THE MASSACHUSETTS DEPARTMENT OF PUBLIC UTILITIES TO JUDGE GREENE THAT "ANY CONSIDERATION OF LIFTING THE LINE OF BUSINESS RESTRICTIONS SHOULD, THEREFORE, BE LIMITED TO THE BOCS, WHERE

IT MAY BE POSSIBLE FOR REGULATORS TO PROTECT AGAINST CROSS-SUBSIDIZATION." COMMENTS AT 4 (MARCH 13, 1987). THIS WOULD MITIGATE THE EFFECTS ON REGULATED CONSUMERS OF THE RHCS' OVERALL BUSINESS AGENDA.

FINALLY, I MUST EMPHASIZE THAT REGULATION WILL NEVER DETECT OR COMPENSATE FOR ALL CROSS SUBSIDIES, WHICH IS WHY I SUPPORT THE ASSESSMENT OR IMPUTATION OF A ROYALTY ON THE BOCS AND RHCS' UNREGULATED BUSINESS REVENUES. THE ROYALTY IS ADDED TO THE LOCAL BOCS' REGULATED LOCAL TELEPHONE SERVICE OPERATIONS. CALIFORNIA AND WASHINGTON STATE BOTH HAVE SUCH PROTECTIIVE MECHANISMS IN PLACE. SAN DIEGO GAS & ELECTRIC CO., APPLICATION 85-06-003, DECISION 86-03-090, 48-49 (CPUC APRIL 2, 1986); PACIFIC NORTHWEST BELL, CASE NO. PR-85-137, ORDER AT 3, PARA. 2 (DECEMBER 31, 1986) (ADOPTING AN "ADDITIVE").

THANK YOU AGAIN FOR THIS OPPORTUNITY TO ADDRESS THE SUBCOMMITTEE. AS IN THE PAST, I STAND READY TO ASSIST CONGRESS AT ANY TIME.

ATTACHMENT I

Office of the
Consumers' Counsel

137 East State Street
Columbus, Ohio 43215

March 31, 1987

Representative Edward J. Markey
United States Congress
2133 Rayburn House Office Building
Washington, D.C. 20515

Re: Telephone Subscriber Line Charges

Dear Representative Markey:

You doubtless have heard that rates for long distance service subsidize rates for local telephone service. To many, this tenet seems as genuine as mom and apple pie. It is not.

Therein lies the story of one of the most successful public relations campaigns of our time. Led by AT&T, the Bell Operating Companies, and other industry giants, this misnomer has been promoted at every turn -- to the public, the media, regulators, elected officials, and to any one else who could affect, or was affected by the outcome of this self-serving crusade.

In response to your call for hearings on the FCC Joint Board's recent recommendation to increase the subscriber line charge (SLC), the Office of the Consumers' Counsel, State of Ohio (OCCO),[1] would like to provide some comments for your consideration. First of all, the concept of "subsidized" local rates (which the SLC is intended to abate) is a misnomer. The proponents of the subsidy argument would have it believed that a subsidy begins with the first cent which long distance rates contribute to paying the costs of the local telephone companies' networks. The premise here is that local customers should pay for the cost of the so-called "local" network.

This is more semantic manipulation than substance. In truth, the substantial cost of a local telephone company's network (telephone wires, etc.) is "a common cost for the provision of local, toll, cellular and other services." Racster, Wong, and Guldmann, The Bypass Issue: An Emerging Form of Competition in the Telephone Industry, 1984 National Regulatory Research Institute (NRRI), p. 151. What this means is that long distance companies [the interexchange carriers (IXCs)] need and use the "local" network to originate and terminate calls just as do customers placing local calls. As joint users, IXCs should pay their way.

Moreover, the "local" network in significant respects is a "long distance network" because it has been constructed to meet the requirements of long distance service. These long distance requirements are more technically demanding and costly than local service requirements, as explained in the following testimony:

---

[1] Under Ohio law, OCCO is the statutory representative of Ohio's residential utility consumers. OCCO is a member of the National Association of State Utility Consumer Advocates (NASUCA), an association of consumer advocates from most of the nation's states.

> Q. ...In saying this, are you saying local networks are designed beyond that which would be necessary just for local service or designed beyond that for the purpose of using toll service?
>
> A. [by Michael Beach, MCI expert witness] When I am talking about local network, I am not talking about simply subscriber plant. So, with that caveat, yes, local networks have been designed in a way that more plant would be required or sometimes more costly plant required to provide a local network that has access to a toll network, to toll networks.

Re Intrastate Access Charges, PUCO Case No. 83-464-TP-COI, Tr. VIII at 153 (October 7, 1983).

> Q. In you opinion would it have been possible to provide a lower grade, lower cost network that was strictly for local service?
>
> A. I think so.

Id. at 154.

> Q. ...What could we -- how would you build the plant differently, physically how would you build it differently?
>
> A. Generally you, depending on the length of the lines that would be required to reach the customers, you could use more metallic facilities, you would have to generally use less carrier. You would be able to perhaps eliminate repeat coils where you would otherwise put them in to reduce the loss, might be able to use smaller gauge cable to reach customers where you might otherwise need to have high gauge cable that has less loss.
>
> You might use less expensive aerial cable that is not as well shielded fom one pair to another to otherwise reduce crosstalk and noise. You might be able to put wires closer together in the right of way as opposed to closer to power lines than you might otherwise have to....

Id. at 181-82; see id. at 177-84 (where Mr. Beach explained the costs imposed upon the LECs' local NTS networks by the IXCs' toll service). (See attached pages.)

Admittedly, the apportionment of network costs between long distance customers and local customers can be an arbitrary process. But the process should be one of apportionment between the joint users of the network, as opposed to an idealogically extreme crusade to end undemonstrated subsidies. Indeed, various approaches have been developed for accomplishing this apportionment, such as relative usage and stand alone cost studies, to name two. See, e.g., 66 Pa. Cons. Stat. Sec. 1325(c) (where the Pennsylvania legislature recently enacted a requirement for sharing of "the costs of the dial tone line, allocated in proportion to the stand alone cost of each class of service which utilizes the dial tone line.").

It might be wondered what can be gained by those who advance the "subsidy" argument which is driving the SLC. A lot. The long distance companies are handed an easy cost reduction at the expense of local customers who must pay the

SLC. (Easy as opposed to the old-fashioned way of reducing costs through such means as increasing productivity and efficiency.)

The local telephone companies have benefited because the SLC is a more stable revenue source than the access charges paid by the long distance companies. There is this stability because local customers are captive to the local companies' monopoly -- there are no alternatives. Moreover, local customers' demand is inelastic -- as telephone service rates increase customers will give up most anything before giving up the necessity of telephone service. The long distance companies are not as dependable of a revenue source because they have the potential for doing untoward things like going out of business or bypassing the local companies. (This latter, much overrated matter of bypass is a self-fulfilling defect of the FCC's per-minute access pricing plan, which could have been remedied by flat rate pricing of the carrier common line charge paid by IXCs -- instead of a SLC.)

The third beneficiary of the SLC is the large business customer that is a heavy user of long distance service. As the SLC goes up, long distance rates go down. Of course, many residential customers (but also large business customers with many access lines but low long distance usage) lose because, for them, lower long distance bills do not offset the SLC. See, e.g., Cooper and Shapiro, Low Income Households in the Post-Divestiture Era: A Study of Telephone Subscribership and Use in Michigan, Prepared for the Michigan Divestiture Research Fund by the Michigan Citizens Lobby, October 1986, pp. 160-63.

This then is the powerful triumvirate -- long distance companies, local telephone companies, and big businesses -- that have profited and will profit from the SLC. This free ride for IXCs is on the backs of the nation's approximately 87 million local residential customers and many local business customers as well, all in the name of eliminating a subsidy of semantics, not substance.

Judge Greene, for one, found this to be a disturbing development:

> It may appropriately be generalized that local telephone service is relatively more relied upon by individuals and that long distance is more business-oriented. If the objective of telephone service available as reasonable rates to all is not to be jeopardized, it is therefore most important that local rates not be burdened by unnecessary increases. As the Court repeatedly pointed out in its August 11, 1982, Opinion (especially in connection with the discussion of the access charge issue (see infra)) there is no legitimate basis for using the reorganization of the Bell System as a means for undermining the universal service objective or as an excuse for raising local rates.
>
> The Court has therefore noted with considerable surprise and some dismay that the Federal Communications Commission, far from using the access charge tool as a means for easing the burdens on the users of local telephone service, has opted instead, in a major decision issued since the Court's approval of the consent decree, to saddle the local subscribers with the access costs

of interexchange carriers. Curiously, although the FCC cites that decree and ostensibly regards its decision as assisting in its implementation, the agency's action runs directly counter to one of the decree's principal assumptions and purposes -- that the fostering of competition in the telecommunications field need not and should not be the cause of increases in local telephone rates.

The Commission's action is undergirded by two premises: first, that long-distance revenues have been subsidizing local rates, and second, that the burden of the Operating Companies' new revenue needs to compensate for the lost "subsidy" must for reasons of policy and economics be borne primarily by the residential subscribers. There is not basis for either of these premises.

In the first place, it is not at all clear that the subsidy assumed by the FCC has ever existed. In its extended oversight of AT&T, and in investigations extending over many years, the Commission was never able to determine whether, in fact, local rates had been subsidized by long distance rates. In spite of that record, the FCC in its December 1982 decision simply ignored the subsidy problem and went on to decide that, subsidy or not, the telecommunications system's fixed costs (see note 37 *supra*) shall ultimately be borne by the individual subscribers. These subscribers, moreover, will bear this burden regardless of how frequently, if at all, they make use of their instruments for long distance calls.

Second, even if it be assumed that there was such a subsidy, it is quite clear that means other than rate increases for residential subscribers are available to make up for the lost funds. It was considered by everyone concerned, including this Court when it approved the decree, that if it were ever determined that AT&T's interstate rates had, in fact, been subsidizing local service, compliance with the law's universal service objective could and would be achieved by replacing the subsidy with access charges levied on the interexchange carriers. Thus, the Court stated in the August 11, 1982, Opinion that the decree

> leave[s] state and federal regulators with a mechanism -- access charges -- by which to require a subsidy from intercity service to local service. By means of these access charges, the regulators would be free to maintain local rates at current levels or they could so set the charges as to increase or decrease local rates (emphasis added).

The Court again emphasized in the concluding part of its Opinion that the Operating Companies would be permitted, under the supervision of state and federal regulators, "to levy access charges upon

> long distance carriers" for use as a subsidy for local telephone rates (emphasis added). 552 F.Supp. at 224 n. 376.
>
> During the public interest proceeding which preceded the entry of the decree no one -- including the FCC -- suggested that access charges should be shifted from the interexchange carriers (which require access to the local networks to enable them to do business) to the local users (who are already paying for those local networks through their telephone rates). In the context of the objective of prescribing low local telephone rates and the goal of universal service that would have made no sense. Yet, that is precisely what the Commission has now decided to do.
>
> The Court has considered it necessary to comment on this FCC action because that action significantly impacts on the Court's own responsibilities in three respects: (1) by its approval of the decree, the Court sought to establish machinery for ratepayer protection that is being jettisoned by the FCC; (2) the FCC action appears to be an effort unjustifiably to assign to the divestiture responsibility for a reallocation of charges which the Commission has decided upon for its own reasons; and (3) the Court is making a considerable effort herein to protect the local rates of telephone subscribers, and it finds it unfortunate that the Commission's decision will tend to defeat that objective.

United States v. AT&T, 569 F. Supp. 990, 997-1000 (D.D.C. 1983) (footnotes omitted) (emphasis added) (original emphasis retained where indicated by Court).

We should add that the FCC has turned a shotgun on the country for addressing a bypass problem which, if it really is a serious problem anywhere, is only such in certain concentrated centers of commerce. As stated in the NRRI Report, a "uniform national policy risks distorting market development." NRRI Report at p. 163. The manager of a small Ohio local telephone company put it more bluntly:

> Subscriber line charges should be capped. My feeling is our small business and residential customers are paying part of the Fortune 500 companies' telephone bills. I can't say the FCC should never revisit end-user charges, since never is a long time. For now, I would expect end-user charges to go no higher and would encourage "small business" to be reclassified from two to six lines.

Revisiting the Access Charge Plan: NTCA Member Managers Speak Out, Rural Telecommunications Journal, Summer 1986, at 30 (comments by Arthur Schimmoeller).

Our comments would not be complete without addressing one other aspect of the FCC's process, that of the linkage of universal service and the SLC. The FCC and the regulated industry have been quite politic in casting the SLC issue as a question of whether universal service will be affected adversely by SLC increases. For the great majority of customers, the question is not can they afford the SLC but whether it is fair for them to pay the SLC -- and we have explained why it is not. For this majority of customers, the lack of a universal service problem has been used by the FCC as an excuse for cost-dumping on the majority's inelastic demand.

The advancement of universal service is an independent obligation of the FCC pursuant to the Communications Act of 1934. To this end, there may be ten to fifteen percent of the nation's consumers that need assistance with their telephone bills. The needs of these citizens should be met without any linkage to the wholly separate question of the SLC.

Finally, OCCO must say that what residential telephone consumers' need more than ever is a national advocate to represent their interests before the FCC, the Federal Courts and the Congress. The tale of the SLC has much to do with corporate power and influence, and consumers should be represented on whatever playing field this question and others appear. While NASUCA and other advocates have been valiant in their efforts, they simply do not have the resources for the magnitude of the task. Therefore, OCCO recommends that a national office of the consumers' counsel be established. (It could be funded for a fraction of what the Joint Board has proposed to devote to the "Link Up America" lifeline program.)

Of course, OCCO and NASUCA stand ready to assist your office and Congress in this and other related matters. Thank you.

Sincerely,

Bruce J. Weston
Associate Consumers' Counsel
(614) 466-8574

BJW/pf

Attachment

cc: Felshaw King,
NASUCA President

William A. Spratley,
Ohio Consumers' Counsel

CHART 1

ATTACHMENT II

Dollar - by - Dollar Breakdown of Local Telephone Bill Increases in Ohio Since Divestiture - January 1, 1984 (monthly charges

Cincinnati Bell	General Telephone (Marion)	Ohio Bell	United Telephone (Mansfield)	
$16.38	$13.54	$14.88	$18.21	Rate January 1, 1984
$19.77	$17.06	$20.41	$20.59	Rate January 1, 1987
$ 3.39	$ 3.54	$ 5.53	$ 2.38	Increase
$ 1.00	$ 1.00	$ 1.00	$ 1.00	FCC mandated access charge June 1, 1985
$ 1.00	$ 1.00	$ 1.00	$ 1.00	FCC mandated access charge June 1, 1986
				Federal-State Joint Board Proposal + .60 June 1, 1987 + .60 September 1, 1988 + .30 April 1, 1989 capped at $3.50 total
- $. 79 Rate decrease after OCC victory in Ohio Supreme Court July, 1984 + $ 2.23 Rate increase November, 1985	$ 1.43 Rate increase August, 1985	$ 2.00 Rate increase February, 1984 $ .50 Rate increase December, 1985		PUCO - ordered rate in-increases
		$ .75 (AT&T)	$ .30	Instrumental rental increases For most companies this is not regulated after January 1 1987

Note: There is a 3% Federal Excise Tax on telephone bills.
Inside wire maintenance was included in flat-rate telephone service util January 1, 1987.

ATTACHMENT III

OCC INTERROGATORIES No. 4

288. Does Ameritech anticipate any new issues of common stock within the period of May 1, 1985 through May 1, 1987?

Object. Vague and indefinite as to what is meant by "Ameritech" and "new issues" and therefore incapable of being answered with a reasonable degree of certainty. However, without waiving such objection, and assuming that "Ameritech" means American Information Technologies Corporation, and that "new issues" means new public issuances of common stock securities, Applicant states that after a diligent search of all likely repositories of such information it has been determined that no such information is within Applicants' possession, custody or control. Ohio Admin. Code 4901-1-20(A)(1).

OCC INTERROGATORIES NO. 4

293. For each outstanding debt instrument of Ameritech:

- a. What was the issuance date?
- b. What is the maturity date?
- c. What is the instrument's bond or other rating?
- d. What was the balance at 12/31/83 and 12/31/84?
- e. What was the effective interest rate?
- f. What was the interest paid during the years ending 12/31/83 and 12/31/84?
- g. Is there a convertibility feature to that instrument?

Objection. Vague and indefinite as to what is meant by "Ameritech" and therefore incapable of being answered with a reasonable degree of certainty. Furthermore, the Interrogatory is also vague and nonspecific in that it does not refer to a specific period of time and cannot be answered with a reasonable degree of certainty. However, without waiving such objection, and assuming that "Ameritech" means American Information Technologies Corporation, Applicant states that after a diligent search of all likely repositories of such information it has been determined that no such information is within Applicant's possession, custody or control. Ohio Admin. Code §4901-1-20(A)(1).

Senator METZENBAUM. Thank you very much. Mr. Millard, we will be happy to hear from you, sir.

Mr. MILLARD. Good morning, Mr. Chairman, and I would like to thank you on behalf of Ameritech for the opportunity to address the Subcommittee this morning.

I would like to come at this subject from two different directions. First, I agree with Mr. Kimmelman, that the consumers are still waiting for the benefits of divestiture.

I think that the reason the consumer is still waiting are the line of business restrictions that keep the regional holding companies from improving the quality of life with information services.

It keeps the regional holding companies from creating new jobs with domestic manufacturing. It keeps the regional holding companies from making our economy more competitive by the provision of interexchange and data services.

And finally, each of the regional holding companies could do an even better job than they are doing today, of keeping rates down and service levels up, if they were allowed to spread the fixed cost of providing telephone service with the other services, that our facilities already in place could provide.

Now it is not hard to see why the present state of affairs with this line of business restrictions does, indeed, confuse the consumers. Why wouldn't a consumer be confused, if an already in-place computer that is used to switch their local telephone calls, with the simple addition of a few lines of computer code, could be automatically used to provide new and valuable information services, information services that are already being provided in a number of foreign countries.

I submit that a lot of the confusion surrounding this line of business restrictions can be subjected to public scrutiny if we step back and examine who are the winners, and, more importantly, who are the losers.

I have just briefly alluded to the fact that I believe the consumers are the losers, because of these restrictions. Well, where there are losers, there are typically winners. Who are the winners?

If today, IBM, AT&T, and GTE were sitting in front of you saying that they would like to have their markets protected from competition, from worthy and sizable competitors like the regional companies, the Committee and most of the people examining this subject would likely approach such a position with a great deal of skepticism.

Mr. Chairman, I believe that is exactly what we have heard this morning. AT&T has said it has sacrificed, it would like to avoid a dispute, it would like orderly, stable, noncontroversial markets. Monopolists like those types of markets.

AT&T is essentially saying "a deal is a deal". We have been broken up. We thought in return for that breakup, we would not have to compete with these companies. AT&T is still saying "a deal is a deal".

IBM, through their affiliate MCI, does not look forward to any further competition in these markets. GTE, which is already permitted to provide these new services under its consent decree, with only corporate separation requirements, is also saying we do not need any more competition.

It has been our view, Mr. Chairman, that it was consumers, not individual competitors, that are the focus of the antitrust law.

We believe the continuation of these MFJ restrictions are contrary to Congress' proconsumer policy, and serve only to protect from competition individual competitors like AT&T, GTE, and IBM.

Consumers, the FCC, the overwhelming majority of State regulators support removal of the MFJ restrictions. I would refer you to the chart that is appended to my formal testimony.

Three of Ameritech's State regulatory commissions have filed comments supporting removal of these line of business restrictions. These restrictions are crippling Ameritech's telecommunications infrastructure.

I would say, in closing, that I met with the Chairman of NEC in Japan last week, who mentioned his visit in 1929 to this country, and related to me his discovery of the two factors that made this such a competitive country.

One factor he said was transportation. The other factor he said was telecommunications. Today, I think it must present an interesting spectacle to the Japanese to see one of those crucial infrastructures in the process of being stultified, and even destroyed, for the purpose of protecting markets for three of our largest industrial corporations. The Japanese must indeed have a different view of competition in this country.

Thank you.

[The statement of Mr. Millard follows:]

STATEMENT OF KENNETH E. MILLARD
ON BEHALF OF AMERITECH

April 30, 1987

Subcommittee on Antitrust,
Monopolies and Business Rights
Senate Committee on the Judiciary

Thank you for the opportunity to testify today before the Subcommittee on Antitrust, Monopolies and Business Rights. My testimony will address the immediate need to remove the outdated line of business restrictions that were imposed on the regional companies in 1982 by the Modification of Final Judgment (MFJ).

It is critically urgent that the regional companies be freed to provide information services, manufacture telecommunications equipment, and provide certain interexchange (long distance) services. Regional company information services will improve the quality of life. Regional company manufacturing will create new jobs. Regional company interexchange and data services will help make U.S. industry more competitive. Finally, regional company entry into each of these businesses will contribute to keeping local service reasonably priced. The consumer and competitive benefits of lifting the restrictions should be denied no longer.

Consumers are the focus of the antitrust law. Individual competitors are not. Consistently throughout the ninety-seven years since the Sherman Act established this country's policy of free and open competition, Congress has held that consumers and the competitive marketplace shall decide what goods are produced, at what prices, and by whom. Continuation of the line of business restrictions is an anathema to Congress's long-held consumer policy of promoting competition. The restrictions inhibit consumer benefits because they hinder industry competition in order to protect individual competitors. The antitrust laws were not meant to protect AT&T, GTE, and IBM from the rigors of competition.

Consumers and state regulatory bodies which represent consumers, in particular residential and small business consumers, strongly support removal of line of business restrictions.

The chart attached to my testimony identifies the positions of consumers and regulatory bodies that have filed comments with the MFJ court. For example, three of Ameritech's five state regulatory bodies have filed comments. Each supports removing the restrictions. Many telecommunications users and consumer groups, such as the National Consumers League, United Press International, Woodward & Lothrop, U.S. Fidelity & Guaranty, Black Citizens for a Fair Media, the Native American Public Broadcasting Consortium, the National Indian Youth Council, the Council of Churches of New York City, the Office of Communications of the Church Federation of Greater Chicago, the Consumer Interest Research Institute, the National Association of State Universities and Land Grant Colleges, the Public Interest Computer Association, and the National Association for Better Broadcasting, also support removal of line of business restrictions.

The danger of disregarding Congress's pro-consumer, pro-competitive policy is now obvious. AT&T negotiated and agreed to the restrictions in the hope of providing itself protection from its most potent competitors. But what has been the result of this anticompetitive policy? The line of business restrictions are crippling America's telecommunications infrastructure, and America is losing its competitive advantage as the world's most technologically advanced country.

The question before this Subcommittee is whether the MFJ should continue to shield industrial giants like AT&T, GTE, and IBM from competition, to the detriment of American consumers and trade, or whether the Congress should now reaffirm its pro-consumer policy by removing the restrictions, re-arming America's technological competitiveness in the process. The rest of my testimony addresses this urgent question in terms of the specific restrictions.

1. Regional company information services will improve the quality of life.

Our society and technology have developed to the point that the availability of information can mean the difference between life and death, fellowship and isolation, prosperity and poverty.

Take several examples:

- Accident victims in the United States receive poorer care than similar victims in Japan, where Nippon Telephone & Telegraph provides telephone service. In an emergency, Nippon Telephone & Telegraph provides Japanese customers an immediate telephone hookup to an emergency medical information center, hospitals, and fire and ambulance stations. The ambulance knows where to take an accident victim because Nippon Telephone & Telegraph's emergency medical information center keeps track of available hospital facilities and inventories of blood and serum on a 24-hour basis. But in the U.S., even to save a life, the regional companies are prohibited from providing information services.
- Two million American deaf persons are isolated from the ubiquitous connectivity that is possible through the telephone network. In the U.S., deaf persons are unable to use the telephone to talk to a friend, buy groceries, negotiate business transactions, or call a doctor. By contrast, some 20,000 to 30,000 deaf persons in France use the French telephone company's videotex system to communicate and transact with each other and with the 2.3 million households and businesses who have the Minitel terminal. Nothing like that is available in the U.S. As a partial solution to enable deaf persons to communicate with non-impaired persons, Michigan Bell is researching the feasibility of providing a text-to-voice conversion service. This service would convert text from a deaf person's teletypewriter into spoken words that non-impaired persons could hear through the telephone. But the MFJ prohibits deployment of such a service.
- The French telephone company's videotex system provides the greatest variety and widest availability of information services of any system in the world. Over 4,000 services are available to over 2.3 million French homes

and offices. French citizens thus have a simple, inexpensive means to obtain useful information relating to banking, finance, stock markets, messaging, electronic mail, travel, education, cultural events, health, science, local and world news (in cooperation with established newspapers such as Le Monde and Parisien Libere), government, and much more. There is no similar American service. The closest service with wide local availability is Vicom, a videotex service provided by the Chillicothe Telephone Company in Chillicothe, Ohio. According to Charles W. "Buzz" Knoles, News and Advertising Director for the Chillicothe service, Ms. LaVersa Motes covers area school board and county commissioner meetings and Ms. Mary Elsass keeps track of goings-on in city government. The system also provides daily police and sheriff reports, want ads, real estate listings, a used car locator, and agricultural news and information including stories from the Ohio Farmer, daily grain and livestock reports, and data from the county agent and 4 H clubs. The Chillicothe service falls far short of the French telephone company's videotex system in terms of sophistication and number of services. But even the Chillicothe-type service is unavailable to the majority of consumers in Ohio and elsewhere in the U.S. who are served by the regional companies.

The information service prohibition must be lifted in order to make advanced information services widely available in the U.S. The success of the Japanese and French systems is due to their putting commonly-used functions in the network, which greatly reduces the cost of terminal equipment needed by individual subscribers. Even an ordinary touchtone pad could be used to access many sophisticated information services but for the MFJ restriction. The regional companies are eager to duplicate the success of their foreign counterparts. Other network-based providers simply have not brought forth widely-available services, their promises notwithstanding. It is especially important to small companies and individuals that such network-based services be made available.

Regional company information services will also help keep down local rates by spreading the fixed costs of using the network. Thus, the National Association of Regulatory Utility Commissioners supports removal of the information services restriction in order to advance first "the goal of universal service at reasonable rates" and second the "national policy in which the benefits of new communications technologies are made available to the many, rather than the few." The Illinois Commerce Commission similarly supports information service relief on the grounds that it "will result in the availability of new services for customers, and may result in decreased basic service costs because of the savings associated with the sharing of local exchange facilities."

2. Regional company manufacturing will create new jobs.

Divestiture has been a bonanza for foreign manufacturers, who have swung the balance of trade for telecommunications equipment from a surplus of $580 million in 1982 to a deficit of $1.9 billion in 1986. Roughly half of all PBXs and virtually all telephone handsets sold in the U.S. are now manufactured overseas. AT&T has laid off thousands of U.S. manufacturing workers while it moves its manufacturing operations offshore to Singapore and Korea.

Allowing the regional companies to manufacture telecommunications equipment would create new jobs for displaced American workers. Ameritech has a proven track record for developing new, American technology:

- With its investment in the American company Northern Information Technology, Ameritech supported the development of a new type of freeze-frame video terminal used by doctors to transmit x-ray pictures over telephone lines.
- By investing in the American company Davox, Ameritech supported the development of an integrated voice and

data terminal that is superior to other products on the market.

- Ameritech's funding of the American company Parallel Computers is directed to developing a new breed of fault tolerant computers that will be used in bringing information services to consumers.
- Ameritech's investment in Speech Plus, another American company, is supporting the development of voice synthesis equipment to allow consumers to access data bases over telephone lines without specialized equipment.
- By its funding of the American company David Systems, Ameritech is helping to develop new capabilities for the telephone keypad and faster data transport using the customer's existing wiring.
- Finally, Ameritech's "University Program" is providing seed capital to stimulate new basic research and development on college campuses in the midwest where Ameritech is headquartered.

Allowing the regional companies to manufacture will also benefit consumers by allowing the regional companies to more rapidly deploy new services such as ISDN, multicarrier 800 services, and operator services. Because the manufacturing prohibition prevents Ameritech from directly developing these new technologies, it must attempt to persuade unaffiliated manufacturers to do so. The manufacturers, however, have existing product lines and the requirements of their own affiliated communications companies that take first priority. Allowing the regional companies to manufacture -- or even to invest in the development of new technologies -- will speed the availability of more innovative, lower-cost services for consumers.

3. Regional company interexchange services will help make U.S. industry more competitive.

For American businesses to compete effectively in world markets the United States must have the most efficient and capable infrastructure possible. Recently, I met with the chairman of NEC, Koji Kobayashi. Mr. Kobayashi observed that the source of America's long-held competitive advantage has been its strength in two industries, transportation and telecommunications.

To maintain America's competitiveness, the regional companies' networks ought to be the most technologically advanced in the world. This is especially critical for small and medium size businesses, which provide most American jobs and depend heavily on the regional companies for their telecommunications needs. But the interexchange restriction prevents the regional companies from providing these customers the low-cost, high-quality services needed to make their operations more competitive in world markets. As consumers such as United Press International are saying, "there is not a competitive 'critical mass' of companies in the telecommunications and data processing marketplace able to offer single point-of-contact, total-solution services."

It is a myth that the regional companies retain any sort of "bottleneck" for business customers. Privately owned PBXs today switch more business users than all the regional companies combined. Private microwave equipment provides more circuits of transmission capacity than all regional company point-to-point business circuits. The millions of additional transport circuits provided by private satellite and fiber optics further negate any argument that a regional company has "market power" for business customers.

Lifting the interexchange prohibition for business services such as private networks will also help keep local rates reasonably priced. Business customers account for a disproportionately large fraction of regional company revenues and profits. If the regional companies cannot provide fully functional end-to-end service to these customers, they will simply abandon the public network, leaving the fixed costs of providing telephone service to be paid by the small users who can least afford it. As the Justice Department's consultant Dr. Huber concluded in his study, without relief to provide end-to-end service for business customers, the regional companies will become "the U.S. Post Office of electronic telecommunications," suffering a steady erosion of revenues. It is crucial, therefore, that the restriction against providing interexchange services to business customers be removed as soon as possible.

4. Regional company data services will further help make U.S. industry more competitive.

An essential piece of the telecommunications infrastructure is data communications. Data communications is the art of enabling different machines to talk to each other, and to people. For example, farmers need data communications to obtain up-to-the-minute information about weather, expected harvests, and spot and futures market prices. Automakers need advanced data communications to arrange timely delivery of materials to the factory, to communicate customer orders to the factory from dealer showrooms, and to improve computer-aided design and engineering techniques that shorten design cycles. Healthcare institutions need data communications between drug manufacturers, hospitals, emergency personnel, laboratories, doctors, and insurance companies.

But the information services restriction prohibits the regional companies from performing integral parts of data communications -- reformatting or storing the transmitted data. And the interexchange prohibition artificially constrains the geographic scope of regional company data communications.

These severe limitations have effectively precluded the regional companies from offering the types of sophisticated data communications services now available from telephone companies in other countries. As a result, almost all data communications in the U.S. are handled through private data networks that large businesses have built for themselves, often using foreign-made, premises-based equipment. Public data services in the U.S. are essentially unavailable except to the affluent and privileged.

A comparison of total revenues illustrates how publicly-available data communications in the U.S. have been stunted by the MFJ prohibitions. In the U.S., the public data communications market generates revenues of about $500 million. In Japan, the public data communications market generates revenues ten times that -- about $5 billion.

What are foreign firms doing with all these data services? They are making their industries more competitive in the world markets. Nippon Telephone & Telegraph, for example, has established an extensive public data network, through which customers may obtain access to videotex services, a Cray supercomputer, and an extensive software library. Nippon Telephone & Telegraph has also established 85 customized data communication networks including the following:

- Agricultural Information Distributing System. Producers, consumers, and distributors use this system to obtain information about the wholesale market for perishables and about harvests.
- Motor Vehicle Registration and Inspection System. This system connects all Land Transport Branch Offices throughout the nation, simplifies application and registration procedures, reduces processing time, and minimizes over-the-counter transactions.
- Automated Meteorological Data Acquisition System. Weather data is collected hourly from 1,400 observation stations throughout the country, 24 hours a day, seven days a week. Typhoons and localized torrential downpours are constantly monitored to minimize disasters.
- Industrial and Financial Use Systems. The nationwide banking system interconnects some 40,000 banks, enables any bank in the country to handle money orders, and reduces the time for money order transfers. The Automatic Cash Dispensing System interconnects cash dispensers in each member bank to permit interconnected on-line transactions. The Financial Information Network connects banks and companies, providing services such as financial trading information, economic and financial market data, fund settlements information, and information on the use and management of capital and assets.

The foreign lead is even more startling respecting deployment of the most advanced data communications technology -- the

Integrated Services Digital Network or ISDN. ISDN allows customers to use their existing copper wiring to transmit data and video signals as well as voice. Where before there could be just one voice conversation for every pair of wires, ISDN allows up to 24 voice, data, and video signals to be transmitted simultaneously over ordinary copper wiring. ISDN is a technological miracle that the U.S. needs to deploy in its telecommunications infrastructure.

Four months ago, one of the Ameritech companies, Illinois Bell, conducted the first customer demonstration of ISDN in the United States. We are very proud of that accomplishment. But two years before the Illinois Bell trial, Nippon Telephone and Telegraph had conducted its first customer demonstration of ISDN in the suburbs of Tokyo. NTT has since expanded its customer trials and will begin offering ISDN on a commercial basis next year. In a ten-year, $100 billion effort, Japan is spending as much to deploy ISDN as the U.S. is spending on the Strategic Defense Initiative. While the Japanese are using these advanced telecommunications capabilities to attack U.S. markets, the U.S. keeps half of its telecommunications talent and resources "quarantined," unable to respond.

The expertise and business know-how of the regional companies should be enlisted to benefit consumers, to help keep local rates reasonably priced, and to improve American competitiveness in world markets. Congress has the final responsibility for antitrust issues, and has the authority to override the MFJ restrictions, which were based on antitrust laws laid down by Congress.

Depending on actions by the MFJ court in the next few months, Congressional action on the MFJ restrictions may be unnecessary at this time. The restrictions are now before the MFJ court for review and Ameritech has asked the court to remove them. Nevertheless, this Subcommittee should continue to monitor the judicial proceedings, and should be prepared to act quickly if the court fails to act in the interest of consumers and the competitiveness of this nation.

COMMENTS OF CONSUMERS, CONSUMER ADVOCATES AND REGULATORS

COMMENTORS[1]	Info. Services	Mfg.	Inter-Exchange	InterLATA Mobile	Non-Telecomm.
American Council on Education	S				
Arizona Corp. Comm'n	S	S	S		
Assoc. of Data Commun. Users	O				
Black Citizens for a Fair Media	S				
California PSC	S	S	S	S	S
Church Fed. of Greater Chicago	S				
Committee of Corp. Telecomm. Users	O		O		
Consumer Fed. of America	O	O	O		
Consumer Interest Res. Institute	S				
Cncl of Churches of N.Y. City	S				
Dist. of Columbia PSC	O	O	O		O
FCC	S	S	S	S	S
First National Bank of Maryland	S	S	S		
Florida PSC	S	S	S		S
H. Geller, H. M. Shooshan, et al.[2]	S	S	S	S	S
Illinois Commerce Commission	S	S	S		
International Commun. Assoc.	O	O	O		
Kentucky PSC	O	O	O	S	S

S = Supports Regional Co. Entry (By Ending Line Of Business Restrictions)

O = Opposes Regional Co. Entry (By Continuing Line Of Business Restrictions)

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[1] Certain of the comments endorsing removal of the line of business restrictions contain conditions -- *e.g.*, preserving state regulatory authority.

[2] These comments were submitted by Henry Geller, Harry M. Shooshan, III, Dr. Charles Jackson, Dr. Everett Parker, Dr. Jeffrey Rohlfs, and Donna Lampert.

COMMENTS OF CONSUMERS, CONSUMER ADVOCATES AND REGULATORS

(Continued)

COMMENTORS	Info. Services	Mfg.	Inter-Exchange	InterLATA Mobile	Non-Telecomm.
Robert Kerrey[3]	S	S	S	S	S
Massachusetts DPU	0	0	0	0	0
Michigan PSC	S	S	S	S	0
Minnesota PSC	S	S	S	S	S
Missouri PSC	S	S		S	S
Motion Picture Association	S				S
Multi Tenant Telecomm. Assoc.			S		
Mutual Benefit Life Ins. Co.	S				
NARUC	S	S	S		
NASUCA	0	0	0	0	0
Nat. Assoc. of State Universities	S				
Nat. Assoc. for Better B'dcastng	0				
National Consumers League	S				
National Indian Youth Council	S				
Native Am. Public B'dcastng Consort.	S				
New York DPS	S	S	S	S	S
Pennsylvania PUC	S	S	S	S	S
Public Interest Computer Assoc.	S				

S = Supports Regional Co. Entry (By Ending Line Of Business Restrictions)

0 = Opposes Regional Co. Entry (By Continuing Line Of Business Restrictions)

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[3] These comments contain a report prepared by Robert Kerrey, former governor of Nebraska, and the Council of State Policy and Planning Agencies in cooperation with the National Governors Association.

COMMENTS OF CONSUMERS, CONSUMER ADVOCATES AND REGULATORS

(Continued)

COMMENTORS	Info. Services	Mfg.	Inter-Exchange	InterLATA Mobile	Non-Telecomm.
Tele-Comm. Assoc.	0	0	0	0	0
U.S. Fidelity & Guaranty Co.	S	S	S	S	S
U.S. Public Int. Research Group	0		0		
United Church Of Christ	0		0		
Vermont PSB	S	S	S		
Videotex Industry Association	S				
Virginia State Corp. Comm'n	S	S	S		S
Washington UTC	0	0	0	S	
West Virginia PSC	S	S	S	S	S
Wisconsin PSC	S	S	S		
Woodward & Lothrop	S	S	S		

S = Supports Regional Co. Entry (By Ending Line Of Business Restrictions)

0 = Opposes Regional Co. Entry (By Continuing Line Of Business Restrictions)

Senator METZENBAUM. Mr. Hoffman, we are happy to welcome you, sir.

Mr. HOFFMAN. Thank you, Mr. Chairman. I am with US Sprint. I am here, as my testimony indicates, to testify as an officer of the Competitive Telecommunications Association or CompTel.

I have set forth in the written statement that we have submitted for the record some of our specific concerns regarding the application of the antitrust laws in this case, and in summary, I would just like to make three or four very brief points, the first of which has already been made several times this morning.

That is that the consent decree, the AT&T divestiture, established with great clarity the legal principle that the Bell Operating Companies cannot be allowed to compete in the long-distance markets so long as they have a local monopoly.

The second point I would like to make is the fact that nothing has changed in that respect since the implementation of the consent decree. The Bell Companies still have local exchange monopolies.

Mr. Rule indicated that the major change was that whereas there was one Bell System, there are now seven companies. But the fact remains that there are not seven companies in each community providing local exchange service. There is only one.

The third point I would like to make, is that despite the fact that nothing has changed, the Bell Companies are now asking for what amounts to a special interest exemption from the antitrust laws, that is to be allowed to enter the long-distance competitive market while they still have control over the local exchange monopoly.

And I think the fourth point that needs to be made is that the Bell Operating Companies' special interest request is not for the benefit of the consuming public. In fact there is great potential that it could harm the consuming public.

If the Bell Operating Companies are allowed to enter the long-distance market while they still have the local exchange monopoly, their unfair competitive advantage could very likely drive existing competitors out of the market and thereby deprive consumers of the benefits of the choice and price and quality of long-distance service that they enjoy today.

And secondly, the Bell Operating Companies' ability to cross-subsidize between monopoly local exchange operations and competitive long-distance rates could very well portend higher local exchange rates for consumers.

It is for these reasons that CompTel has opposed the Bell Company efforts to remove the AT&T consent decree restrictions on long-distance, and in that respect, we were pleased to see the Department of Justice's report on Monday of this week, that indicated that the restriction against them entering the long-distance business remains today in the public interest.

And if I could, Mr. Chairman, I would like to take just a minute of the remaining time I have to respond to a statement that Mr. Millard just made.

I find it somehow remarkable, that a Bell operating company can accuse us of sitting here today, asking for protection from competition by the Bell Companies, when in fact what is going on is, as I mentioned, the Bell Operating Companies are asking for a special exemption from the antitrust laws.

I think it has to be recognized, that the situation that exists today has been through the courts, all the way to the Supreme Court and affirmed by the Supreme Court, and what they are asking now is to overturn that decision for their benefit.

We are not asking here to be protected from competition. We are the product of competition. We thrive on competition. Thank you, Mr. Chairman.

[The prepared statement of Mr. Hoffman follows:]

Before the
UNITED STATES SENATE
JUDICIARY COMMITTEE
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

Dirksen Office Building
Washington, D.C.
April 30, 1987

Hearings on the U. S. Department of Justice
Recommendations to Modify the AT&T Consent Decree

Testimony by: John R. Hoffman
Senior Vice President
US Sprint Communications Company
and
Chairman of the Board
Competitive Telecommunications Association

Thank you, Mr. Chairman and members of the Subcommittee, for the opportunity to appear before you and share with you the views of over one hundred members of the competitive long distance telephone industry. The Competitive Telecommunications Association (CompTel) and its predecessor associations have represented the interests of resellers, OCCs and fiber carriers on legislative issues in Washington, D.C. for over five years. Our members provide long distance service in competition with AT&T in virtually every state in the nation.

My company, US Sprint, is an active member of CompTel and is the second largest nationwide competitor to AT&T. We were formed in July of last year by the combination of US Telecom and GTE Sprint. Since then, we have made great progress not only in the marketplace, but also in constructing the nation's first all-digital fiber optic voice and data telecommunications network. As of this month, we have completed 16,000 of the planned 23,000 miles of this technologically advanced network which reaches into every state and is now accessible by over half of the population. The cost of this endeavor has been very high--over two billion dollars to date--but our partners (United Telecom and GTE Corp.) remain committed to providing high quality and low cost long distance service to the consuming public.

Indeed, all members of this competitive long distance industry, regardless of their size, have made a substantial commitment to bringing the benefits of new choices, greater efficiencies and innovative technology to the American public.

We are all committed to a genuinely competitive marketplace and that is why we are so concerned about the premature entry of the Regional Bell Operating Companies (RBOCs) into the long distance line-of-business. The RBOCs were prohibited from entry into long distance by the Modified Final Judgment (MFJ) for very legitimate reasons which still hold true today.

The MFJ stands for the legal principle that the integration of the RBOCs' local exchange monopoly services with competitive long distance telecommunications service is antithetical to the federal antitrust laws. Stated simply, the RBOCs should not be allowed to compete in the interexchange market while they retain _de facto_ monopoly control over local access facilities. As Judge Greene has observed, to permit the RBOCs to enter the market for interexchange services would be "to contravene the [MFJ's] prohibitions in the most direct and obvious way,"[1] given the dependency of the interexchange carriers on the RBOCs' bottleneck monopolies. Indeed, Judge Greene has found that even to leave open the _possibility_ of RBOC entry into the long distance market would have serious anticompetitive consequences, as long as the RBOCs continue to exercise bottleneck control over the local exchange:

> [I]f the [RBOCs] perceive themselves as future long distance competitors they will have incentives to spend ratepayer funds for long distance construction and to position themselves for successful entry [into the interexchange market] by discriminating against other carriers in interconnection and by delaying their achievement of equal access.[2]

For these reasons, Judge Greene held that he "will not even consider the substantive merits of [an RBOC's] request seeking permission to provide interexchange services until such time as the Regional Bell Holding Companies lose their bottleneck monopolies and there is substantial competition in local telecommunications service."[3]

While the Department of Justice (DOJ) initially proposed to permit the RBOCs to enter the interexchange market on an "out-of-region" basis, the Department has now reconsidered this proposal. In the filing with Judge Greene earlier this week,[4] the Department concluded--correctly--that a general prospective order allowing the BOCs to provide interexchange services outside their regions could "create serious practical difficulties and would be unlikely to produce any significant benefits to consumers."[5]

With good reason, Justice admitted to serious doubts about the "feasibility of specifying in advance the technical and business parameters that should be used to distinguish between 'in-region' and 'out-of-region' services."[6] In the absence of a "clear, competitively relevant and easily enforceable distinction between 'in-region' and 'out-of-region' interexchange services," the Department recognized that its proposal to permit the RBOCs to provide long distance services outside their local regions would likely prove difficult, if not impossible, to enforce.[7]

CompTel commends the Department's decision to retain the MFJ's bar on the provision of interexchange services by the RBOCs, and its recognition that the RBOCs' continued control of the local exchange bottleneck enables them to undermine interexchange competition.[8] However, we must take issue with the Department's continuing assertion that "where...legal barriers to intraLATA competition are removed, the BOCs should be able to provide interexchange services."[9]

In its April 27 filing, the Department recommends that an RBOC's request to enter the long distance market should be measured against the standards of Section VIII(C) of the decree.[10] (That provision states that the RBOC proposing a waiver of the line-of-business restrictions must demonstrate that there is "no substantial possibility that [the RBOC] could use its monopoly power to impede competition in the market it seeks to enter.") It appears, however, that an RBOC seeking to enter the long distance market could satisfy Justice that there is "no substantial possibility" that competition will be impeded if the RBOC can show that the states in its region have lifted the legal barriers to competition in the market for local exchange services. That, according to the Department, will "break" the RBOCs' bottleneck control over local exchange services and facilities.

DOJ's suggestion that the "bottleneck" problem will be solved by the removal of legal barriers to local and intraLATA competition is fundamentally flawed, and, if it is adopted, will undermine the continued development of competition in the long distance market. The problem with the RBOCs' exclusive control over local exchange facilities was never that legal barriers to entry exist. The problem has always been--and remains--that as a practical matter, there is no ubiquitous alternative to the RBOCs' local networks for origination and termination of calls over competitive interexchange networks.

Even if a state removes regulatory barriers to the competitive provision of local exchange services, the RBOCs will likely retain their bottleneck control of the local exchange. Merely opening a market to legal competition does not automatically make that market effectively competitive. Moreover, until the RBOCs' monopoly control over local access no longer exists, the RBOCs have the ability to cross-subsidize their competitive ventures with revenues derived from basic local service.

The point is that the antitrust concern of the RBOCs' monopoly control over local exchange facilities cannot be abated by changing local laws. There must be a viable de facto alternative for local access before the RBOCs' power to unfairly discriminate against or among interexchange carriers can be found to no longer exist.

The RBOCs' bottleneck control is by no means a thing of the past. Some RBOCs have contended that the threat of bypass has "broken" the "bottleneck"; but Dr. Peter Huber, the Department's own expert, found that most of the interexchange traffic in this country is originated and terminated over LEC facilities.[11] Although there still are substantial difficulties in obtaining interconnection with the RBOCs, most CompTel members have not "bypassed" the Bell companies--for one very simple reason:

competitive carriers recognize that the success of their business depends upon access to all customers, and that, in turn, requires interconnection with the RBOCs. There are, as a matter of fact, simply no alternatives with the reach and ubiquity of the RBOCs.

Notwithstanding DOJ's most recent recommendations, there will doubtless be continued pressure from the RBOCs to permit them to enter the long distance market. We can expect that some RBOCs will argue, as they have in the past, that their entry into this market is necessary to ensure the existence of financially viable competitors. They point to the February 2 report by the Justice Department to Judge Greene's court, wherein the DOJ noted that in the aggregate interLATA competitors have been able to achieve only about a 20% market share. Many competitors and industry observers have often described in public, before the FCC, and in Congress the staggering institutional advantages which give AT&T the ability to retain a dominant market position.

The truly remarkable point is not that AT&T has thus far retained a dominant market share, but rather that competition has grown despite AT&T's inherited advantages. The current long distance market structure is already bringing the benefits of lower cost and more service options to the public. This market structure can succeed in the long run. What is needed is a prudent Federal policy governing the transition to full competition, not another major upheaval in that market structure.

One of the greatest concerns of the competitive long distance telecommunications industry has been the fact that the rules for participating in this market have been constantly changing over the past ten years. By establishing clear antitrust principles, the MFJ provides a framework for the continued development of competition in the long distance marketplace. The Justice Department has apparently reaffirmed those rules, although, as I have noted, we are disturbed by signs that the Department may yet be willing to sacrifice long distance competition on the completely theoretical altar of "alternatives" to the local loop that may develop if state regulatory laws are changed.

We would hope that the DOJ and Judge Greene will resist efforts to lift the bar on the RBOCs' provision of long distance services, for to give in to those efforts would do great violence to the basic antitrust principles so carefully established by the MFJ. Even though there are now seven RBOCs instead of one "Bell System," the fact is that the RBOCs are still the sole providers of local service in their vast regional exchange areas.

In any event, if competition is ever to be given an opportunity to succeed, the market rules must be established with some certainty and given adequate time to operate in the public interest. That is particularly so when the impetus for change is not to enhance the competitive market, but to restore the unfair advantages to monopoly providers of local exchange service which have been found to be in conflict with existing antitrust laws.

That is why CompTel and US Sprint opposed DOJ's initial proposal to lift the MFJ's ban on the provision of long distance service by the RBOCs.[12] We believe the MFJ was a reasonable, necessary, and legally appropriate means to address the antitrust concerns raised by the Bell System's abuses. Nothing has really changed in the three short years since the implementation of the MFJ on January 1, 1984, particularly in the provision of interexchange services as it might affect the basis of the line-of-business restrictions contained in the MFJ, and we see no other need or reason to modify the interLATA prohibition.

Instead, we believe the public interest would be better served if the RBOCs spent their resources accomplishing the conversion of their end offices so sometime in the foreseeable future competitors will be able to enjoy access equal to what they provide to AT&T everywhere AT&T enjoys it (as initially ordered by Judge Greene). That is what is needed to promote interexchange competition in the long run, not the recreation of the old Bell System times seven. The Justice Department appears to have come late--but not too late--to this conclusion. I am hopeful that Judge Greene and the Senate will agree, and that we can all get on with the task of providing the benefits of fair competition to the consuming public pursuant to stable, certain, and rational rules.

ENDNOTES

[1] United States v. Western Elec. Co., 592 F. Supp. 846, 867 (D.D.C. 1984).

[2] *Id.* at 867-68.

[3] *Id.* at 868.

[4] Response of the United States to the Comments on its Report and Recommendations Concerning the Line-of-Business Restrictions (filed April 27, 1987).

[5] *Id.* at 39.

[6] *Id.* at 40.

[7] *Id.* at 42.

[8] *Id.* at 28-38.

[9] *Id.* at 48.

[10] *Id.* at 53.

[11] Huber, The Geodesic Network, Table IX.5. (Bottleneck Index for Various Categories of Interexchange Access).

[12] Copies of the formal comments filed with Judge Greene on March 13 and April 27, 1987, by CompTel and US Sprint are attached hereto as exhibits.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
)
Plaintiff,)
)
v.) Civil Action No. 82-0192
)
WESTERN ELECTRIC COMPANY, INC.)
AND AMERICAN TELEPHONE AND)
TELEPHONE COMPANY,)
)
Defendants.)

COMMENTS OF US SPRINT COMMUNICATIONS COMPANY ON THE REPORT AND RECOMMENDATIONS OF THE UNITED STATES CONCERNING THE LINE OF BUSINESS RESTRICTIONS

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March 13, 1987

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
)
Plaintiff,)
)
v.)
) Civil Action No. 82-0192
WESTERN ELECTRIC COMPANY,)
INC. AND AMERICAN TELEPHONE)
AND TELEGRAPH COMPANY,)
)
Defendants.)

COMMENTS OF US SPRINT COMMUNICATIONS COMPANY ON THE REPORT AND RECOMMENDATIONS OF THE UNITED STATES CONCERNING THE LINE OF BUSINESS RESTRICTIONS

US Sprint Communications Company ("US Sprint") hereby submits its comments on the "Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment" ("DOJ Report"). US Sprint opposes the recommendations of the Department of Justice ("DOJ" or "Department") that would eliminate or relax the Modification of Final Judgment's ("MFJ" or "Decree") restrictions on the provision of interLATA and information services by the Bell Operating Companies ("BOCs").

The line-of-business limitations were proposed by the parties and adopted by the Court in order to prevent the BOCs from leveraging their monopoly power over local exchange facilities into competitive businesses. In the three years since entry of the decree, there has been no significant dissipation of BOC market power. Nevertheless, DOJ now recommends open entry for the BOCs in information services and, under limited circumstances, even interLATA services. In the absence of significant diminution in the BOCs' local monopoly power, however, the Department's recommendations fail to meet the standard set forth in Section VIII(C) of the Decree for removal of the restrictions.

I. INTRODUCTION

A. Description of US Sprint

US Sprint is a joint venture of GTE Corporation ("GTE") and United Telecommunications, Inc. ("United"). GTE and United each own a 50 percent general partnership interest in US Sprint, which was created to combine the telecommunications businesses formerly provided separately by several subsidiaries of the partners, including GTE Sprint,[1] GTE Telenet and US Telecom, Inc.

US Sprint is the third largest interLATA carrier in the United States. It is currently expanding its capacity and improving its service through construction of a 23,000-mile nationwide fiber optic network, of which 5,000 miles already are in service. In addition to offering a wide variety of interexchange services, US Sprint, through its subsidiary Telenet, provides data services, including a packet switched network with protocol conversion capabilities, electronic messaging, and other information services.

B. Background: The Line-of-Business Restrictions and The DOJ Recommendations Regarding Interexchange and Information Services

The line-of-business restrictions in the MFJ were established to prevent "the occurrence or reoccurrence of anticompetitive conduct by the Operating Companies - each of which retains in its particular area a monopoly over local telecommunications service and thus has the potential for using its monopoly power to discriminate against others."[2] Specifically, with respect to interLATA and information services, the MFJ prohibition was meant to remove BOC incentives to discriminate against competitors in providing access to the local exchange network and to cross-subsidize competitive offerings with local exchange revenues. The interexchange restriction also was intended to neutralize BOC incentives to prolong or subvert the implementation of equal access.

The information services ban was similarly created to forestall discrimination. In addition, the information services prohibition was meant to motivate the BOCs "to design their local networks to accommodate the maximum number of information service providers."[3]

This Court has emphasized the importance of the role of the interexchange and information services restrictions to achieving the overall purposes of the decree. For this reason, the Court has followed a "go slow" approach in its consideration of waivers under Section VIII(C), noting "that the entry of these companies into competitive markets [should] proceed at a measured pace."[4] The need for such a deliberate attitude is obvious. As the Court remarked:

> [E]ven to leave open the possibility of Regional Holding Company entry into this market would have negative implications, for if the companies perceive themselves as future long distance competitors they will have incentives to spend ratepayer funds for long-distance network construction and to position themselves for successful entry by discriminating against other carriers in interconnection and by delaying their achievement of equal access.[5]

Recognizing the potentially anticompetitive nature of the restrictions, however, the Court included a standard for their removal in Section VIII(C) of the decree. That standard was devised to be consistent with DOJ's view "that the restrictions are justified by the mere existence of monopoly power,"[6] and states that the prohibitions may be eliminated when "there is no substantial possibility that [a BOC] could use its monopoly power to impede competition in the market it seeks to enter."[7] In ruling on requests for waiver of the line-of-business restrictions, therefore, the Court has required a demonstration of "changed circumstances" in regard to BOC market power.[8]

The DOJ Report, and the Huber Report upon which DOJ's recommendations rely, recognize that the BOCs retain their ability to engage in anticompetitive conduct harmful to interexchange competitors.[9] Nevertheless, DOJ recommends that the Court adopt exceptions to the interLATA prohibition. It proposes that the BOCs be permitted immediately to provide interexchange communications that neither originate nor terminate within the BOCs' regions ("out-of-region exception"). Moreover, when state regulatory restrictions on intraLATA competition have been removed, DOJ recommends that the in-region restrictions be lifted as well.[10]

The Department also recommends elimination of the information services prohibition because it is "no longer necessary to protect competition and may result in significant costs to consumers in the form of lost efficiencies or unavailability of services".[11] While the DOJ Report recognizes that the BOCs continue to have the opportunity and incentive to cross-subsidize their competitive information services, it relies on recent FCC regulatory actions in its Third Computer Inquiry[12] and the Joint Cost Proceeding[13] to provide sufficient safeguards to constrain the BOCs' anticompetitive potential. Thus, DOJ urges the Court to ignore the Section VIII(C) standard for removal of the line-of-business restrictions and instead, defer to the FCC as to the time and manner of BOC entry into the information services market.

II. THE DEPARTMENT'S RECOMMENDATION FOR REMOVAL OF THE INTERLATA RESTRICTION FOR OUT-OF-REGION SERVICES FAILS TO MEET THE SECTION VIII(C) STANDARD

The Department states that "changes in the relevant competitive conditions and the Department's experience during the intervening period convince us that a nationwide ban [on interLATA services] is no longer necessary."[14] The referenced changes are the implementation of equal access and the development of the Regional Holding Companies ("RHCs") into seven distinct independent entities. DOJ views these events as changes which have dissipated the market power of the BOCs.

Based on these changes, the Department proposes to allow the BOCs to provide interLATA services outside their regions. DOJ justifies this recommendation on the grounds that, if the BOCs' interLATA activities are restricted to geographic areas where they have no bottleneck facilities, their market power cannot be abused to the detriment of competition. As demonstrated below, however, the so-called "changes in the relevant competitive conditions" on which the Department relies cannot properly serve as a basis for modifying the interLATA prohibition. Moreover, the out-of-region limitation is an inadequate restraint on potential BOC cross-subsidization and discrimination.

A. DOJ Has Not Demonstrated That Competitive Conditions Have Changed Since Entry of the Decree

1. The Equal Access Process Has Not Yet Been Completed and Does Not Significantly Prevent Anticompetitive Action

DOJ's reliance on "progress" in the implementation of equal access as grounds for lifting the restriction on out-of-region interexchange services is misplaced.[15] While equal access is important, it cannot properly be viewed as a panacea for all competitive ills.

Equal access, in and of itself, does not dissipate the local exchange "bottleneck" nor significantly impede BOC opportunities and incentives to engage in anticompetitive behavior. The mere conversion of a central office to equal access does not stymie a BOC's ability to abuse its monopoly power in providing local service. It is widely recognized that inequality of technical interconnection arrangements are only one of many ways in which a BOC can discriminate against a competitor.[16]

Further, regardless of progress toward equal access, universal equality in interconnection is years away, even in major metropolitan areas. Until that time, the value of equal access in fostering interLATA competition is less than DOJ now assumes. Even at the beginning of 1987 about 25 percent of the nation's telephones remained unavailable to the OCCs on an equal basis.[17]

Moreover, as US Sprint and others have demonstrated in filings before the Federal Communications Commission, the pricing policies imposed by the FCC in implementing equal access have actually disadvantaged the OCCs vis-a-vis AT&T.[18] Thus, competition today is even more vulnerable to improper BOC conduct than before the equal access process began.

In short, DOJ's bald assertion that the implementation of equal access represents a significant change justifying removal of the interLATA restriction is unsupportable. The equal access process at this point has not neutralized BOC market power.

2. The Alleged Independence of the RHCs Is Irrelevant to Removal of the Restrictions

The Department finds an additional changed circumstance in the alleged newly developed independence of thought among the seven RHCs. DOJ concludes that this lack of parallelism or joint action[19] "preclude[s] any one BOC from having the ability unilaterally to impair competition in the [entire] interexchange market through the discriminatory provision of exchange access."[20] As the previous discussion demonstrates, however, even BOCs acting independently within their respective regions remain the sole providers of bottleneck facilities to interLATA carriers, creating opportunities for discrimination. Collusion among the BOCs could make such abuses more damaging, but even one such company acting alone retains the ability to inflict significant harm to interLATA competition.

Moreover, DOJ's reliance on this claim of new-found independence of the BOCs ignores the intent of the MFJ. The line-of-business restrictions were created to neutralize each BOC's residual monopoly power, not just the possibility of collusive behavior among the BOCs. In fact, it was in recognition of this fact that DOJ earlier argued that the mere existence of monopoly power required the restrictions.[21] As detailed herein, the growth of the RHCs as independent companies does not alter the market power of each BOC and thus the need for the interLATA services prohibition. Consequently, even if DOJ is correct that the BOCs do not engage in parallel action,[22] that fact would not constitute a basis for removal of the interLATA restraint because it fails to reach the underlying purpose of the restriction.

3. Premature BOC Entry into the Interexchange Market Would Prevent the Development of Interexchange Competition

In view of the absence of changed circumstances, a BOC offering of interexchange services could result in the demise of competition. This possibility is emphasized by the tenuous nature of competition in the interexchange business today. Despite significant OCC subscriber growth since divestiture, interLATA competition remains extremely fragile. Other than AT&T, facilities-based interexchange carriers and resellers are generally acknowledged to be suffering serious financial duress.[23] Under these circumstances, the entry of the BOCs, with all their opportunities for discrimination and cross-subsidization, will undoubtedly inflict substantial harm to the prospects for vigorous competition in the interexchange market.

In short, there are no "changed circumstances" sufficient to justify removal of the restrictions pursuant to Section VIII(C). Consequently, the Department's recommendation to remove the restriction for out-of-region service could be defensible only if the interexchange restriction was overbroad as originally entered. The Department does not suggest that this is the case, however, and US Sprint opposes any such notion.

B. Limiting the BOCs to Out-of-Region InterLATA Service Will Not Prevent Anticompetitive Abuses

In addition to concluding that "changed circumstances" justify liberalization of the interexchange prohibition, DOJ asserts that the BOCs' local monopoly power cannot be exercised effectively to enhance their competitive position out-of-region.[24] Although DOJ concedes that BOC entry into the interexchange marketplace would entail "substantial risks of discrimination or cross-subsidization"[25] which could jeopardize interexchange competition, nonetheless, it concludes that "[i]t is unlikely that a BOC's independent provision of interexchange services outside of its region would have anticompetitive effects because, outside of its region, a BOC does not control any local exchange 'bottlenecks'."[26]

The DOJ's assessment of the potential for anticompetitive conduct by the BOCs is too narrowly focused. Even though a BOC may not control bottleneck facilities outside its territories, it still has both the incentive and ability to abuse its control over local facilities to harm interexchange carriers with whom it competes outside the region.

1. Access Charge Terms and Prices

As is the case with any competitor, it may be presumed that a BOC will seek to exploit any and all advantages over its rivals in order to compete successfully.[27] The interexchange carriers' dependence upon a BOC's in-region access facilities provide the BOC with leverage to enhance its competitive posture elsewhere. For example, a BOC might delay the provisioning of local access facilities or the connection of presubscribed customers to an interexchange competitor who successfully won a large private line customer out-of-region. Not only would such action "discipline" the competitor for its conduct, it would be a disincentive to the company to pursue vigorously other BOC out-of-region customers.[28]

In addition, the BOC could price its in-region access facilities so as to weaken out-of-region competitors. An interexchange carrier forced to pay unreasonably high access charges to a BOC in-region will be a less formidable competitor out-of-region.

DOJ acknowledges that "the complexities of the access charge pricing system give the local BOC ample opportunity to manipulate access prices to its own advantage."[29] Nor does it suggest that the opportunities for anticompetitive discrimination and cross-subsidy disappear with the advent of equal access.

The BOCs' ability to manipulate access pricing as well as terms and conditions for access to its own advantage is more than a theoretical possibility. Recent examples of BOC activities US Sprint regards as harmful to competition include the following:

- o Bell Atlantic has proposed to block all interLATA calls placed over WATS access lines by interexchange carrier customers in Virginia, West Virginia and New Jersey. According to Bell Atlantic, customers attempting to place intraLATA calls over WATS access lines in these jurisdictions will receive a recorded voice announcement informing them that such calls cannot be completed over the line being used by the caller. US Sprint was informed of this restriction in a meeting held with Bell Atlantic to discuss Bell Atlantic's plans for providing WATS access line service. US Sprint objected to this restriction and asked whether there was any technical reason why Bell Atlantic could not divert and complete the intraLATA calls over its own network. Bell Atlantic replied that there was no technical impediment to diversion and that the restrictions are a "strategic" decision of the company.

- o Southwestern Bell's access tariff for 800 Service requires that interexchange carriers report to Southwestern Bell certain proprietary, customer-related, and competitively sensitive information so that Southwestern Bell will be able to bill 800 Service customers for all intraLATA 800 calling. While US Sprint has intraLATA authority in Texas and Missouri (which alone generate more than two-thirds of Southwestern Bell's net revenue for interstate access), Southwestern Bell claims that

> it has the right to carry all "1+" intraLATA traffic in those states and that because it regards all 800 calling as "1+" traffic, it has the exclusive right to carry such traffic.

In addition, an overriding potential for discrimination is created by the BOCs' continued inability to provide accurate access billing. In many cases, the full bill for access service is not rendered until almost two years after the service has been provided. Moreover, US Sprint routinely discovers large errors, discrepancies or undocumented charges in the access bills it receives from the BOCs. Correcting such problems often requires lengthy and difficult negotiations. If the BOC, in its discretion, disallows the disputed amount, US Sprint still must pay the amount plus applicable interest. Failure to pay, even if US Sprint continues to contest the amount owing, could result in substantial deposit requirements, failure to process new access orders, or discontinuance of service. Clearly, access billing provides the BOCs ample opportunity for competitive abuse.[30]

2. Bypass and Cross-Subsidy

The out-of-region limitation may not be effective in preventing BOCs from actually bidding for networks which serve customers within their regions. In order to maintain in-region customer control with a minimum of financial harm, the BOCs will be motivated to make it both practically and economically feasible for large in-region users to "piece-out" their networks. Such users will be urged to connect private in-region networks to the BOC's out-of-region Point of Presence ("POP") nearest the in-region subscriber's premises by means of a private facility or some other bypass medium.[31]

For example, a customer with a New York City office subscribing to NYNEX's out-of-region service could provide its own communications link from New York to a NYNEX switch located out-of-region in Jersey City, New Jersey, just across the Hudson River. This link to the out-of-region switch could be provided by any number of non-NYNEX resale or facilities-based carriers, or by a simple one-hop private microwave connection.[32] Once connected to the New Jersey switch, calls could then be transferred to any location served by the NYNEX out-of-region network. This system also could be used to terminate calls from out-of-region points to the in-region location. In this way, the BOCs would be able to compete with the OCCs for the private line traffic of large business customers even if some network points are in-region. Because the BOCs could not use message or common facilities to reach in-region points, they would be encouraged, in effect, to assist in bypass of their own local services.

Contrary to DOJ suggestions, restricting the BOCs to out-of-region service will not significantly limit their ability to engage in improper cross-subsidization. Despite geographic separation, many joint and common costs are shared among the monopoly and competitive services (e.g., administrative personnel, training, accounting, billing, advertising and general and administrative overhead). Moreover, in-region facilities and switches could be used to transmit traffic which originates and terminates out-of-region. Accordingly, there would be many opportunities to misallocate this cost burden to the regulated monopoly service, enabling the company to underprice its competitive offerings.[33]

3. Absence of Public Benefits

While the dangers to existing interLATA competition from BOC entry are clear, there would not appear to be any countervailing competitive benefits in allowing the BOCs to offer out-of-region service. It is highly unlikely that a BOC, or any other carrier, could successfully offer an interLATA dial-up message service (MTS or WATS) under the out-of-region condition. There are no economic advantages which a BOC could properly offer which would offset the inconvenience of having to utilize two different interLATA carriers (the BOC out-of-region and a second carrier in-region).[34]

A BOC might offer private line network services out-of-region but, here again, it would often be necessary for the network to serve the BOC's territory. This could be accomplished as described above, by connecting the customer's in-region points to the BOC point-of-presence out-of-region by private facilities supplied by a second interLATA carrier. Even if the inconvenience of such a bifurcation of network control, maintenance, and so on, could be overcome, such a network configuration may be unprofitable. With the new high capacity transmission technologies which have become prevalent, such as fiber optics, private line services alone may not permit a new entrant in the interLATA market to attain traffic volumes sufficient to reach minimum economies of scale within a reasonable period.

Despite serious questions as to the economic feasibility of such a service, nonetheless there are a number of reasons (e.g., customer control) which could motivate a BOC to offer it. Moreover, the less successful the BOCs' interLATA ventures become, the more likely that improper cross-subsidy or discrimination will occur. The result would be the worst of both worlds. The existing competitors to AT&T would be harmed by unfair competition, possibly even driven from the marketplace entirely, while the BOCs' monopoly ratepayers would subsidize uneconomic interLATA service. These circumstances inevitably would lead to increasing pressure to allow the BOCs to provide in-region service regardless of legal barriers to local competition or the original intent of the decree.

III. THE DEPARTMENT'S PROPOSAL TO ALLOW IN-REGION SERVICE WHEN REGULATORY BARRIERS TO ENTRY AND RESALE OF LOCAL SERVICE ARE REMOVED IS INCONSISTENT WITH THE DECREE'S VIII(C) STANDARD

The Department's recommendation that the BOCs be allowed to provide in-region interLATA service when they can demonstrate that there are no legal restrictions on intraLATA entry or resale assumes that the BOCs' ability to leverage their monopoly power is removed by local deregulation. However, until actual competition is demonstrated, there is no guarantee that the mere removal of state regulatory restrictions would constrain a BOCs' ability to engage in anticompetitive conduct.[35]

The Department claims that "the removal of regulatory constraints would have the immediate effect of subjecting the BOCs to substantial competitive pressures."[36] The threat of competitive entry, in turn, would lower the risk of misconduct by the BOCs. At the same time, however, DOJ acknowledges that its proposal would permit removal of the in-region restraints even if a residual core of monopoly service remains.[37] US Sprint fails to perceive the likelihood of "substantial competitive pressures" in the face of a "residual core" of monopoly service. This inconsistency in the Department's position serves to emphasize the speculative nature of the recommendation.

In effect then, the Department is urging adoption of a new standard for removal of the restrictions, one that is based on whether *de jure* obstacles to competition with the BOCs are present, not on the *de facto* Section VIII(C) standard. The Department incorrectly equates elimination of regulatory barriers to entry with eradication of monopoly power. Clearly, this is not the case, since monopolies often arise in industries where there are no government entry barriers.[38]

Section VIII(C) of the Decree was adopted in anticipation of a time when the BOCs' monopoly power had dissipated.[39] Although the elimination of restrictions on intraLATA entry and resale may be a first step in eroding this power, there is no guarantee that it will have the intended effect. It would be premature to lift the restriction merely on the prediction that competition will develop and the BOCs' monopoly power will disappear. If the mere absence of governmentally imposed barriers to entry were all that the antitrust laws require, there would have been far fewer cases brought over the years.

More fundamentally, there is no need to speculate on this matter. It is the elimination of *de facto* market power which removes the possibility of abuse. The elimination of *de jure* restrictions on market entry is relevant insofar as it leads to a removal of *de facto* monopoly power. However, the repeal of *de jure* restrictions alone is not the test. The Department's proposal is contrary to the VIII(C) standard and should be denied.

IV. DOJ'S POSITION ON INFORMATION SERVICES IS BASED UPON INCORRECT ASSUMPTIONS AND UPON FAITH IN FCC SAFEGUARDS WHICH ARE UNDEFINED OR UNTESTED.

As with interLATA transmission, the Department's effort to portray "changed circumstances" in information services since the entry of the decree will not withstand scrutiny. The DOJ Report relies upon three basic arguments in this regard: information services have developed outside the local exchange network to a greater degree than expected; the public is being denied new services and the benefits of economic efficiencies because the BOCs cannot provide information services; and new FCC regulations to prevent BOC anticompetitive actions have altered the appropriate balance between judicial and regulatory roles.

Much of the rationale provided by the Department for its proposed relief, however, is based on erroneous assumptions. DOJ's effort to describe dramatic changes since 1982 in the BOCs' monopoly exchange services and in the information services industry is substantially inaccurate. Developments in these markets have been evolutionary, not revolutionary, and the incentives and abilities of the BOCs which gave rise to the bar in 1982 have not changed materially.

A. DOJ Gives No Basis for the Assertion that Information Services Are Not Primarily Dependent Upon Access to the Local Exchange Network

The DOJ Report alleges that "when the decree was agreed to by the parties and entered by the Court, most information services still were in a formative stage," and while the future was unclear, "it appeared likely to the Department and the Court that the nascent information services would be analogous to interexchange services in their relationship to and dependence on the local exchange."[40] The obvious implication is that information services are now less dependent upon local exchange access then originally believed in 1982.

Neither the Department, nor the Huber Report upon which it relies, however, demonstrate the basis for this conclusion; in fact, a large number of information services were and continue to be dependent upon local exchange access. Moreover, it is not coincidental that these are the very areas which the BOCs are most anxious to enter and which are most likely to be harmed by such entry.[41]

The implication that information services were in a "formative stage" in 1982 and have since developed differently than expected also is erroneous. The computer-based information services industry has existed for more than 20 years, offering database and remote access data processing services, and has been one of the most dynamic sectors of the U.S. economy. Thousands of such services -- generating billions of dollars in annual revenues -- have been offered for many years. They certainly were not speculative at the time the decree was written.

Nor is it an answer to the potential danger of BOC anticompetitive conduct to suggest that the competing information providers may "bypass" the local exchange. The DOJ Report's discussion of bypass, based on the Huber Report's analysis, makes plain that bypass alternatives for information services are quite limited and actually reinforces that fact that local exchange access remains essential for almost all remote access information services.[42]

B. The DOJ Report Gives No Basis for the Assertion that the BOCs Can Provide Information Services More Efficiently than Existing Competitors That Do Not Have Local Exchange Operations

The Department states that "[s]ome information services can most efficiently be provided at the level of the switch, *i.e.*, on an integrated basis."[43] However, DOJ also candidly admits that "it is difficult, if not impossible, to predict whether location within or outside the network will be most efficient for any given information service."[44] Nor does the Department make any effort to hide the fact that the existence or extent of efficiency gains which flow from integration cannot be ascertained.[45] Despite these obvious uncertainties, DOJ urges the elimination of the information services restriction on this basis.

While DOJ obviously is confident that no problems will arise, US Sprint suggests that faith alone does not meet the Section VIII(C) standard. This Court has previously rejected the argument that the BOCs can most efficiently provide information services by taking advantage of various economies (such as using the same equipment for exchange telecommunications and for information services). It would be impossible to determine at any time whether the BOCs' advantages were due to inherent efficiencies or to efficiency created by structuring the network so as to hinder competition. No reason has been demonstrated for the Court to abandon its prior conclusion.

C. The Regulatory Safeguards Relied Upon by DOJ to Thwart BOC Anticompetitive Actions Are Not Yet in Existence.

At bottom, the Department asks this Court to share its faith in the efficacy of the FCC's nonstructural safeguards -- the CEI/ONA plan adopted in Computer III and the Joint Cost accounting rules -- as a substitute for the structural separation decreed in Computer II.[46] The Department implicitly concedes that these safeguards will not be implemented for a number of years. However, DOJ finds "undesirable" a retention of the MFJ's information services restrictions pending final FCC rulings on these matters.[47] Thus, it urges early elimination of the restrictions, in essence asking the Court to defer to the FCC as to the timing and the manner of BOC entry into the information services market. US Sprint submits that such action is grossly premature for several reasons.

First, it must be recognized that the FCC's Computer III decision itself is not final. It remains the subject of a number of petitions for reconsideration -- including those of several BOCs who have challenged aspects of its ONA safeguards. Beyond those requests for amendment of the Order, the Commission is now conducting further proceedings in Phase II of Computer III and in CC Docket No. 86-421 to consider other approaches to the regulatory status of enhanced data services, including protocol conversion when offered by BOCs and other dominant carriers. Until these proceedings are concluded, the final regulatory structure governing the BOCs' provision of enhanced services (the protocol conversion which the Department implies is almost, but not quite, an "information service") remains an unknown.

Uncertainty also surrounds the nature of Open Network Architecture ("ONA"). The FCC has described ONA only in the most general terms, and has delegated to the industry the task of developing the specifics of ONA. The BOCs, however, are not obliged to file their initial ONA plans until February 1, 1988 -- and their implementation will be delayed until after the FCC has considered public comment and ruled upon their adequacy.[48]

Given the complexity of implementing the full unbundling of basic network functions contemplated by ONA, and the fact that significant new engineering and software development efforts will be required, the FCC has mandated only that the BOCs implement the "initial" portions of their February 1988 ONA plans within one year of the approval of such plans. It is unrealistic to expect that the BOCs will offer anything approaching full ONA for several years.

To the extent that the FCC has described ONA, it is clear that it does not contemplate "equal access" for information service competitors of the BOCs in the sense ordered by the decree. The Commission considered, but rejected, a requirement that BOCs offer enhanced service competitors the opportunity to co-locate such competitors' equipment in their central offices in order to enable them to access the BOCs' local exchange networks on a basis equal to that provided the BOCs' own co-located enhanced services, i.e., at equal per-line costs of interconnection.

Instead the FCC opted for a partial cost-averaging approach under which the BOC's own co-located enhanced service would share only a portion of the costs of access from the central office to non-co-located competitors. Specifically, the FCC required each BOC to offer "cost-minimized transport" to competitors, consisting of three elements: (1) a multiplexer in the central office (to carry multiple subscriber signals over a single line to the competitor, thereby reducing loop costs somewhat); (2) a transmission line from the central office to the competitor's separate premises; and, (3) a matching multiplexer at the competitor's premises. The FCC required the BOC's own enhanced service to share the first of these three cost elements, but not the latter two, despite the fact that such costs will be incurred only because the BOCs refused to afford co-location to their competitors. Depending upon the number of lines involved in a particular case, this can increase the competitor's per-line cost of interconnection to many times that incurred by the BOC's own co-located enhanced service. No apparent consideration was given by the FCC to adopting an equivalent to the "Five-mile Rule" contained in the MFJ to equalize the local access costs of competitors to AT&T in the interexchange carrier market.[49]

Similarly, the recently adopted non-structural accounting rules have yet to be tested. The Order adopting those rules is not yet final, and the BOC cost allocation plans are not due until September 1987. It is very difficult to construct a workable, effective system of cost accounting where a large pool of joint and common costs must be allocated among a multitude of services -- some monopoly, some competitive -- and where the carrier has the incentive to misallocate wherever possible. This goal, in fact, has eluded the Commission for over a decade.[50] The latest attempt will begin in September when the BOCs submit their cost allocation plans.[51]

In addition, such cost accounting rules will apply only to interstate services, and not to intrastate activities (which, of course, account for the bulk of the BOCs' investments and costs). That the Department may have been lulled into a belief that these rules would have a broader applicability is understandable; in Computer III the FCC specifically preempted the states from imposing structural separation, or non-structural safeguards, "inconsistent with those adopted in this Order."[52] Several weeks later, however, in Louisiana Public Service Commission v. FCC, [53] the Supreme Court held that Section 2(b) of the Communications Act[54] imposed limitations upon the Commission's preemption power apparently not anticipated by the FCC. Thereafter, in its Joint Cost Order, released shortly after the DOJ Report, the Commission concluded that "preemption would not be desirable."[55] Thus, unless and until the States adopt accounting rules governing the allocation of investments and costs across the boundary between regulated and nonregulated services, the ability of BOCs freed of the information services bar to cross-subsidize such activities with monopoly intrastate revenues would be unconstrained.

However, beyond this large hole in the coverage of the FCC's non-structural safeguards, US Sprint's fundamental disagreement with the Department regarding the information services restriction relates to the fact that the rules upon which the Department would have the Court rely remain to be defined. The Court cannot now be assured of the terms of the final safeguards, much less how they will be implemented. Thus, elimination of the information services restriction at this time would remove the BOCs' incentive to work toward truly effective plans for ONA and joint cost accounting.

For these reasons, US Sprint urges that the Court reject DOJ's recommendations concerning information services but without prejudice to their resubmission accompanied by a demonstration that (a) the FCC's Computer III proceedings have been concluded in a decision that assures that competition in the information services market would not be impaired by BOC entry; (b) ONA Plans which provide equal access to competing information service providers have been approved by the FCC, have been implemented by the BOCs, and are efficacious; (c) BOC accounting plans have been approved by the FCC and implemented by BOCs; and (d) comparable accounting plans have been implemented by the BOCs at the State level.

CONCLUSION

For the foregoing reasons, the MFJ line-of-business restrictions governing interexchange and information services should not be modified as recommended by the Department of Justice.

Respectfully submitted,

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March 13, 1987

CERTIFICATE OF SERVICE

I, Lydia S. Furnells, hereby certify under penalty of perjury, that on this 13th day of March, 1987, I caused copies of the foregoing "Comments of US Sprint Communications Corporation on the Report and Recommendations of the United States Concerning the Line of Business Restrictions" to deposited in the United States mail, first-class postage prepaid addressed to the parties or their counsel specified in Appendices A and B of the Court's Order of February 26, 1987 and to counsel for the United States:

Lydia S. Furnells

ISSUE CHECKLIST FOR COMMENTS FILED IN RESPONSE TO THE UNITED STATES REPORT AND RECOMMENDATIONS OF FEBRUARY 2,1987

Name of Party or Intervenor: US SPRINT COMMUNICATIONS COMPANY

Please indicate the broad areas that you have addressed in your attached filing by checking the appropriate blanks below and indicating the pages on which you address each subject.

		Pages
X	Interexchange Services Restriction	7 - 23
X	Information Services Restriction	23 - 33
	Equipment/Manufacturing Restriction	
	Nontelecommunications Business Restriction	
	AT&T's Motion to Modify the Waiver Screening Procedure	
	Other Issues	

ENDNOTES

[1] US Sprint is the successor to GTE Sprint as an intervenor in this proceeding. Accordingly, we request that the Service List be corrected to substitute US Sprint for GTE Sprint.

[2] United States v. Western Elec. Co., 592 F. Supp. 846, 852 (D.D.C. 1984).

[3] United States v. Western Elec. Co., 552 F. Supp. 131, 188-89 (D.D.C. 1982) aff'd mem. sub nom., Maryland v. United States, 460 U.S. 1001 (1983).

[4] 592 F. Supp. at 858 n.42, 855.

[5] Id. at 867-68.

[6] Id. at 195.

[7] Id. at 231.

[8] "The line of business restrictions . . . constituted an essential ingredient of the decree. Yet none of the requests for waivers is accompanied by a showing or even an allegation of changed circumstances that would justify a departure from the restrictions." 592 F. Supp. at 859 (footnote omitted).

[9] DOJ Report at 65-67; Huber, The Geodesic Network, 1987 Report on Competition in the Telephone Industry, (January 1987) ("Huber Report") at 3.2-3.7.

[10] DOJ Report at 59, 67. In addition, DOJ also recommends that the restrictions on interLATA mobile, paging and specialized services be removed. Id. at 77. US Sprint believes that the Court should continue to apply the conditions previously placed on such BOC activities. United States v. Western Elec. Co., 578 F. Supp. 643, 651 (D.D.C. 1983); United States v. Western Elec. Co., No. 82-0192, Order, slip op. at 2-4 (D.D.C. Jan. 28, 1987).

[11] DOJ Report at 104.

[12] Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), 104 F.C.C.2d 958 (1986) ("Computer III").

[13] Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, CC Dkt. No. 86-111, Report and Order, FCC 86-564 (rel. Feb. 6, 1987) ("Joint Cost Proceeding").

[14] DOJ Report at 71.

[15] DOJ Report at 65.

[16] Cf. United States v. Western Elec. Co., 627 F. Supp. 1090, 1094 n.7 (D.D.C.), rev'd on other grounds, 797 F.2d 1082 (D.C. Cir. 1986) (noting such practices as slowdowns in interconnection; abusive regulatory and legal tactics; manipulation of access pricing). See Huber Report at 3.21-38; DOJ Report at 91-97.

[17] Huber Report at 3.15.

[18] See, e.g., Joint Petition for Expedited Rulemaking, Investigation of the Policies Necessary for a Transition to Effective Long Distance Telephone Competition, RM-5057, filed June 17, 1985 ("Joint Petition"); see also, Huber Report at 3.14 n.52 (describing TDX petition alleging equal access difficulties).

[19] If the DOJ position on this issue is adopted by the Court, it would appear that at a minimum the BOCs should be barred from interLATA joint ventures with each other or with AT&T. Removal of the restrictions based, in part, on a lack of joint action should reasonably assure that future joint action is prohibited, thus precluding the de facto recreation of the Bell System.

[20] DOJ Report at 73.

[21] 592 F. Supp. at 859.

[22] Many opportunities are present for information exchange and concerted or parallel action, through BellCore, trade associations, and otherwise. However, as discussed above, DOJ's proposal is inappropriate regardless of whether the BOCs have become "independent."

[23] It might be noted that, historically, OCC gains have come from the growth in the demand for interexchange services, not from diminution of AT&T's volume of traffic. And even the competitors' success in garnering a portion of the growth in the market, the Huber Report suggests, is because AT&T is accepting some reduction in its market share, though not in its revenues, to win relaxation of regulatory oversight. However, in 1985 AT&T's increase in MTS traffic volumes exceeded the growth rate of the market as a whole. Huber Report at 3.3.

[24] DOJ Report at 70-72.

[25] Id. at 66.

[26] Id. at 71-72.

[27] Huber at 3.29. See also, California Public Utilities Commission, A Report on Pacific Bell's Affiliated/Subsidiary Companies, Proceeding No. A.85-01-034, (June 3, 1986).

[28] Of course, if an interexchange carrier receives delayed or poor quality facilities from a BOC, harming the competitor's ability to serve its customers, the company's reputation and customer relations will suffer. Injury to the general business reputation of the competition obviously would aid the BOCs in competing for out-of-region business.

[29] DOJ Report at 91.

[30] US Sprint would also note that a BOC may be more reasonable in settling disputed accounts with those interexchange carriers with whom it does not compete out-of-region.

[31] See Restrictions on Interconnection of Private Line Services, 60 F.C.C.2d 939 (1976).

[32] It is noteworthy that FCC rules permit sharing and for-profit resale of private microwave systems. See, e.g., 47 C.F.R. § 94.17 (1986).

[33] *See* Huber Report at 3.29. *See also* H. Averch and L. Johnson, "Behavior of the Firm Under Regulatory Constraint", 52 American Econ. Rev. 1052, 1058 (1962).

[34] Because a BOC could not terminate service nationwide, it could not participate in the Commission's carrier selection process. Investigation of Access and Divestiture Related Tariffs, 101 F.C.C. 2d 911, 933 (1985), *recon. denied*, FCC 85-598 (rel. Nov. 14, 1985).

[35] As DOJ itself notes, "given AT&T's strong position . . . and the difficulty of entry on a nationwide scale, it is especially important that the BOCs not be permitted to engage in anticompetitive conduct that might be fatal to AT&T's smaller, and in some cases vulnerable, competitors." DOJ Report at 67.

[36] Id. at 97.

[37] *Id*. at 98. In addition, US Sprint is concerned by the vagueness of this and other aspects of DOJ's in-region conditions. They must be clarified to allow for meaningful comment.

[38] *See*, *e.g.*, United States v. Aluminum Co. of America, 377 U.S. 271, *reh'g denied*, 377 U.S. 1010 (1964).

[39] The MFJ recognizes that "[t]his change could occur as a result of technological developments which eliminate the Operating Companies' local exchange monopoly." 552 F. Supp. at 194.

[40] DOJ Report at 108.

[41] The Department also finds difficulty in defining information services. DOJ Report at 106-07. As an example, it asserts that "full integration of packetizing and protocol conversion with switching has been blocked by decree and regulatory constraints." *Id*. at 117. US Sprint believes that the "confusion" as to the definition of "information services" is vastly overstated. The definitions and distinctions contained in the decree are straightforward, and have not prevented the BOCs from network integration. In conceding that the FCC has waived its *Computer II* rules to permit the BOCs to provide "some protocol services on an integrated basis," DOJ fails to describe any protocol services for which a BOC has requested an authorization which was not granted. *Id*. In fact, the FCC granted the BOCs permission to offer the very services they sought, and DOJ acquiesced in such action. That DOJ's argument is a makeweight, moreover, is evidenced by the fact that the Department does not proffer any definitional refinements, but seeks to eliminate the "confusion" by removing the restriction. In short, there is no real confusion on this point.

[42] DOJ Report at 127-28. Dr. Huber's description of how larger corporations have utilized CPE to create internal data processing and retrieval systems independent of local exchange access, or have turned to physical delivery of optical storage discs, misses the point. Even AT&T never asserted as a defense to the Government's complaint that the ability of people to converse face-to-face mitigated any concern as to its competitive activities in the telecommunications market.

[43] *Id*. at 113.

[44] *Id*. at 114.

[45] *See id*. at 115; 552 F. Supp at 189 n.238.

[46] DOJ gives no explanation for its sudden change in attitude concerning reliance on regulation to prevent anticompetitive actions.

[47] DOJ Report at 148.

[48] It is not unreasonable to expect that greater BOC energy will be devoted to the effort of the ONA process if it is seen as a prerequisite to entry. See DOJ Report at 140 n. 278.

[49] 552 F. Supp. at 233-34.

[50] The FCC's past experience with cost accounting confirms the difficulty of the task. See, e.g., MCI Telecommunications Corp. v. FCC, 675 F.2d 408, 412 (D.C. Cir. 1982).

[51] A further reason that reliance on FCC regulation is inappropriate is the Commission's recent proposal to deregulate dominant carriers, including the BOCs. In its Docket CC No. 86-421, the FCC issued a Notice of Proposed Rulemaking which proposes, inter alia, the "streamlining" and eventual full deregulation of all services provided by dominant carriers pursuant to competitive bid procedures (so-called "contract services"). Under such an approach, interstate access obtained from a BOC after competitive bidding would be tariffed at separate, and presumably lower, rates than those found in its existing tariffs.

[52] 104 F.C.C. 2d at 1128.

[53] 106 S.Ct. 1890 (1986).

[54] 47 U.S.C. § 152(b)(2).

[55] Joint Cost Proceeding at ¶ 88. In seeking reconsideration of the FCC's Computer III Order, US Sprint noted that the subsequent Louisiana decision cast substantial doubt upon the ability of the FCC to preempt the States with respect to safeguards. In light of this, US Sprint urged the Commission to reappraise the cost-benefit analysis underlying its decision to remove structural separation.

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. WESTERN ELECTRIC COMPANY, et al., Defendants.	Civil Action No. 82-0192

COMMENTS OF COMPETITIVE TELECOMMUNICATIONS ASSOCIATION ON THE REPORT AND RECOMMENDATIONS OF THE DEPARTMENT OF JUSTICE

The Competitive Telecommunications Association ("COMPTEL"), by its attorneys and pursuant to the Court's Memorandum and Order of February 4, 1987, hereby submits these Comments on the "Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment," filed by the United States Department of Justice ("the Department" or "DOJ") on February 2, 1987.[1]

I. INTRODUCTION

COMPTEL is the principal industry association of competitive interexchange telecommunications carriers. Its member companies include newly-emergent national, regional and localized long distance carriers who compete with AT&T and the Bell Operating Companies ("BOCs"),[2] but who also must rely upon the BOCs' bottleneck monopolies for access to their customers.

COMPTEL's primary interest in this proceeding concerns the DOJ recommendation that the Modification of Final Judgment ("MFJ")[3] be revised to emasculate its prohibitions on BOC provision of interexchange services. DOJ Report at 7. As shown below, as long as the BOCs continue to possess substantial bottleneck control over local exchange telephone services, any relaxation in the MFJ's interexchange services prohibition would have a high probability of recreating the concentration of market power that the MFJ was designed to eliminate and certainly would severely reduce the current degree of competition in the interexchange services market.

II. THE MFJ IMPOSES A CLEAR AND STRICT STANDARD FOR REMOVAL OF THE INTEREXCHANGE SERVICES PROHIBITIONS

The opinion adopting the MFJ and subsequent opinions issued by the Court in this proceeding provide a detailed explication of the Court's rationale for imposing a total prohibition on interexchange service provision by the BOCs:

> To permit the Operating Companies to compete in this [interexchange] market would be to undermine the very purpose of the proposed decree -- to create a truly competitive environment in the telecommunications industry. . . . If the BOCs were free to provide interexchange services in competition with the other carriers, they would have substantial incentives to subvert . . . equal access requirements. . . . Finally, the [BOCs] would also have the ability to subsidize their interexchange prices with profits earned from their monopoly services.

MFJ, 552 F. Supp. at 188-89 (footnote omitted).

The MFJ also established an unambiguous, "bright-line" standard for future removal of the interexchange prohibition: "[A] restriction will be removed upon a showing that there is no substantial possibility that an Operating Company could use its monopoly power to impede competition in the relevant market." Id. at 195 (footnotes omitted; emphasis added).

The Court has amplified this standard in subsequent opinions. In 1984, in response to BOC requests for line of business waivers, including an explicit request for waiver of the interexchange services prohibition, the Court stated that it "will not even consider the substantive merits of a waiver request seeking permission to provide interexchange services until such time as the Regional Holding Companies lose their bottleneck monopolies and there is substantial competition in local telecommunications service."[4]

The DOJ Report seemingly acknowledges these standards at some places, but elsewhere it seeks to substitute a less stringent standard, presumably because its recommendations as to the interexchange prohibitions are so at odds with the established facts and with the "Huber Report"[5] upon which DOJ "rel[ies] heavily."[6] For instance, the Department commences its discussion of "The Legal Standard for Removal of the Line of Business

Restrictions" by repeating the standard from the MFJ quoted above. See DOJ Report at 45. Yet within five pages, in a rather obtuse paragraph, it claims that the line of business restrictions should be retained only if it is "likely" that a BOC could impede competition in the interexchange market. Id. at 50.

DOJ also declares that it "agree[s] with the Court that the competitive cost-benefit standard incorporated in the decree provides the appropriate standard for review," id. at 46. However, the MFJ and the Court's subsequent opinions in this proceeding nowhere articulate or support a cost-benefit analysis approach for removal of the restrictions.

This Court has repeatedly and unequivocally stated that there are "overwhelming" pro-competitive justifications for the interexchange restriction. MFJ at 189. The restrictions must be retained until such time as a petitioning BOC makes a showing that "no substantial possibility" remains that it could use this power to impede interexchange competition, id. at 231 -- that is, until each of two conditions are met: "the [BOCs] lose their bottleneck monopolies and there is substantial competition in local telecommunications service." 592 F. Supp. at 868 (emphasis added). Thus, a party seeking removal of the restrictions has the affirmative burden of demonstrating that these conditions have been satisfied.[7/]

III. THE COURT'S PREREQUISITES TO REMOVAL OF THE INTEREXCHANGE SERVICES PROHIBITION HAVE NOT BEEN MET

There can be no legitimate contention that the first and preeminent condition has been satisfied. Neither Dr. Huber, the FCC nor any other regulatory body has concluded that the BOCs' local exchange bottlenecks have dissipated. The only claimed loosening has occurred in a rather amorphous segment of the interexchange marketplace -- very large business users.

The Huber Report and numerous regulatory proceedings confirm that the BOCs continue to have an "economic chokehold" on all other users. Huber Report at 3.8. DOJ can do no more than trumpet bypass "trends" that at some undefined and indefinable future date "may" reduce BOC bottleneck power over some undefined and indefinable larger group of interexchange users. The Court as well as the consumers and entrepreneurs who have recast their expectations and behavior based upon the MFJ are entitled to much more empirical evidence of change before the interexchange prohibitions are disturbed.

DOJ's interexchange recommendations should be rejected and DOJ should be directed to continue to monitor these "trends" carefully and report again at the next triennial review. Unless and until these trends become reality, there is no basis for removal or relaxation of the interexchange prohibitions.

A. DOJ Is Unable to Cite Any Developments That Have Materially Vitiated BOC Local Exchange Monopolies

Simply stated, the DOJ Report cites no technological or market developments in the three years since the MFJ took effect that have substantially weakened the BOCs' monopoly control over basic telephone service and the local exchange. Instead, while the DOJ Report and the Huber Report point to hopeful competitive trends and assert that "building blocks for competition at the local level of the exchange are falling into place," Huber at 2.25, both reports expressly concede that to date only modest competitive inroads have been made, and only with respect to large user markets.

For example, DOJ finds that "[t]echnological developments have decreased slightly, but have by no means eliminated, the dependence of interexchange carriers on BOC switching and hauling services as a means of connecting customers to interexchange facilities." DOJ Report at 79. DOJ acknowledges further that "the BOCs' opportunities for discrimination and cross-subsidization still exist to varying degrees with respect to certain types of currently prohibited activities, especially activities within a BOC's region." Id. at 5.

Based on Dr. Huber's findings, DOJ concludes that "[w]hile the local exchange bottleneck may be eroding, it is far from impotent."[8/] Huber had found that small users still must depend on local exchange carriers (LECs) for switching. Even in the case of large users, "for short haul transmission all companies are still quite dependent on LEC facilities."[9/] Indeed, DOJ duly notes Dr. Huber's finding that only about one-tenth of one percent of all interexchange traffic volume, generated by about one ten-thousandth of one percent of customers, bypasses the local exchange carrier.[10/]

B. NTIA's Report Confirms that Competition in the Local Exchange Does Not Exist Today

A February 1987 Report by the National Telecommunications and Information Administration on "Competition in the Local Exchange Telephone Service Market" (the "NTIA Report") reaches many of the same conclusions, albeit with apparent reluctance in light of NTIA's well-known policy predilections in this area.[11/] NTIA finds that while the BOCs are "vulnerable" to local exchange competition, they "do not yet face a great deal of competition for many of their services and customers." NTIA Report at v, 45. NTIA concludes that "few customers wholly abandon RHC networks," id. at 47; that the "service bypass phenomenon" appears to be "abating," and customers are returning to BOC switched access service, id. at 23-24; that high capital costs and operating expenses deter competition in wired local transmission systems, while radio-based systems have severely limited capacity due to lack of available spectrum, id. at 28; that digital termination service (DTS), once thought by some to be a viable competitive offering within the local exchange, has not developed as anticipated, id. at 40, 49; and that if the BOCs obtain greater pricing flexibility through deregulation, customers could be still less inclined to seek services from non-BOC suppliers, id. at 50-51.

Thus NTIA, like Dr. Huber, finds that while opportunities for local exchange competition and independent interconnection to interexchange carriers may develop in the future, the BOC local exchange bottlenecks today remain intact.

C. The DOJ and Huber Reports Confirm that Competition Is Virtually Nonexistent in the IntraLATA Toll Market

In fact, the DOJ and Huber Reports demonstrate that there is actually less competition in a large and important segment of the interexchange market -- that is, intraLATA toll service, a $15 billion market which generates one-third of all toll revenues.[12/] The DOJ Report notes that, in approving the LATAs established under the divestiture reorganization plan, "the Court emphasized that LATAs were not intended to be areas of BOC monopolies." The Department quotes the Court's emphatic declaration that "the lack of competition in this market would constitute an intolerable development." *United States v. Western Electric Co.*, 569 F. Supp. 990, 1005 (D.D.C. 1983). The Court went on to find that "the significant amount of the traffic that is both intrastate and intra-LATA should not be reserved to the monopoly carrier." *Id.*[13/]

Yet there is today minimal competition in the intraLATA toll market. "Each BOC carries close to 100 percent of the intraLATA toll traffic in its area." Huber Report at 3.5. Dr. Huber also finds that post-divestiture activities by the BOCs are largely responsible for this lack of competition: "The MFJ does not expressly require the BOCs to provide ICs with equal access to this market, and they don't." *Id.* at 3.15. There is no requirement that BOCs provide "1+" dialing for intraLATA calls. *Id.* Dr. Huber refers to reports that

> immediately after divestiture AT&T and the BOCs initiated 'an aggressive lobbying campaign' to fight OCC competition in intrastate markets. On the one hand they sought legislation to prohibit long-distance intra-LATA competition. On the other, they sought relaxed state regulation over their own intra-state pricing policies.[14/]

The success of the BOCs' efforts in this regard is apparent: facilities-based intraLATA competition is permitted in only 14 states.[15/] Dr. Huber also notes that several states have raised "*de facto*" barriers to competition, such as limiting interexchange carriers to a single point of presence ("POP") in any LATA. All states have protected the local exchange carriers as the only carrier to which customers can subscribe for their intraLATA toll service.[16/]

Thus, there is in fact far *less* competition in this key long-distance market than the Court anticipated when the MFJ and the Reorganization Plan were approved.

D. DOJ Bases Its Interexchange Recommendations on Perceived Trends Rather than Current Market Conditions

At bottom, the DOJ Report seeks to satisfy the Court's standard governing removal of the BOC interexchange restrictions on the basis of perceived trends and supposed eventualities, rather than present-day marketplace realities.

DOJ observes correctly: "Clearly, it will not be easy to measure the risk to competition of the BOCs' entry into markets now closed to them or to predict the success of regulatory controls in further limiting those risks." DOJ Report at 52. It concedes that "the BOCs' opportunities for discrimination and cross-subsidization still exist," id. at 5, and that technological developments have only "decreased slightly, but by no means eliminated, the dependence of interexchange carriers on BOC switching and hauling services," id. at 79. DOJ also observes, among other things, that "small users still must depend on LECs for switching," id. at 42, and that scarcely one-tenth of one percent of all interexchange volume moves directly from a non-LEC facility to an interexchange carrier. Id. at 80.

DOJ nevertheless manages to conclude that "changes in the relevant competitive conditions and the Department's experience during the intervening period convince us that a nationwide ban is no longer necessary." Id. at 71. Apparently the Department's sanguinity is founded upon the Huber Report's assessment that "[t]he building blocks for competition at the local level of the exchange are falling into place." Huber Report at 2.25.

However, even assuming that this assessment by Dr. Huber is basically valid,[17/] building blocks are but the unassembled raw materials, not the building itself or even its foundation. As Dr. Huber notes: "For the present, competition is strong in some patches, wholly absent in others," id., and interexchange carriers "still receive all but a trickle of their traffic through LEC switches." Id. at 1.18. One-tenth of one percent of the interexchange traffic in the United States goes directly from one node of Dr. Huber's geodesic dome to another; all the rest still moves through the narrow funnel maintained by the BOCs.

Likewise, the FCC has recognized that the BOCs' bottleneck monopolies continue virtually unabated. The Chief of the FCC's

Common Carrier Bureau recently stated that "for low-volume traffic origination and termination, it [the local exchange] is not a workably competitive market."[18] In sum, there is universal agreement among regulatory authorities and interested observers -- including DOJ and Dr. Huber -- that the BOCs' local exchange bottlenecks still exist for the vast majority of consumers.

The MFJ's predicate for removal of the BOC restrictions, however, is not based upon developing trends and possible eventualities, but rather upon present marketplace conditions. Specifically, the decree states that these restrictions "shall be removed upon a showing by the petitioning BOC that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter." MFJ § VIII.C, 552 F. Supp. at 231 (emphasis added).[19] The Court's concern with the present rather than the unknowable future state of telephone competition is exemplified by its statements that it "will not even consider" removing or waiving interexchange restrictions "until such time as the [BOCs] lose their bottleneck monopolies," and that "[t]hat is not now." 592 F. Supp. at 868. See also 627 F. Supp. at 188 n.26 ("No movant has claimed that this condition now exists, and it plainly does not" (emphasis added)).

The Huber Report acknowledges that that time is not yet upon us. Indeed, Dr. Huber declares: "The major telecommunications challenge in the next decade is the seamless interconnection of the intelligent nodes already in place." Huber Report at 1.27. The DOJ Report concedes this present reality yet, undaunted, irrationally recommends the immediate partial elimination of the interexchange restrictions. See DOJ Report at 59.

E. The Post-Divestiture Behavior of the BOCs Confirms the Wisdom of the Nationwide Interexchange Services Prohibition

The Court's fear that the BOCs would engage in anticompetitive behavior if allowed into interexchange services has been confirmed by their behavior since the adoption of the MFJ. The BOCs have leveraged their local exchange market power to disadvantage interexchange service providers to the maximum extent possible under federal and state regulations in a number of different ways.

1. IntraLATA Equal Access. The BOCs continue to deny interexchange service providers even nominal equal access for intraLATA services. Indeed, the BOCs universally do not provide interexchange carriers with equal access in the form of presubscription or "1+" dialing for intraLATA toll services.[20] The BOCs typically provide 1+ intraLATA access only to themselves. See supra pp. 10-11.[21] Customers of competitive interexchange carriers are forced to dial as many as seven extra digits in order to reach their intraLATA carrier of choice.

This unequal access has the same anticompetitive effect on intraLATA competitors of the BOCs as unequal access was judged to have on interLATA competition. See MFJ, 552 F. Supp. at 195-97. It substantially inhibits the new entrants' efforts to develop viable alternatives to the BOCs' intraLATA services, an extremely important market comprising one-third of all toll revenues. See Huber Report at 3.15.

The BOC denial of equal access services for intraLATA toll is compounded by their pricing policies. Even though the BOCs refuse to provide "1+" dialing to intraLATA competitors who use Feature Group D facilities, they charge these carriers full premium access charges under their intrastate tariffs.[22]

In addition, even in states that permit intraLATA competition, the BOCs will "strip" intraLATA toll calls made by a competitive carrier's customers, unbeknownst to the customers, and route them over their own facilities instead of those belonging to their interexchange competitors. This occurs because customers utilize 1+ dialing without knowing their LATA boundaries and the different dialing procedures for intraLATA and interLATA calls.[23]

In reality, there is no equal access of any kind provided by the BOCs to competitive carriers for intraLATA services. Without presubscription and 1+ dialing, customer access to interexchange carriers, if it exists at all, is patently unequal and inferior to that which the BOCs provide themselves.

2. IntraLATA Entry. This Court has recognized that the absence of competition in the intraLATA market "would constitute an intolerable development . . . . [T]he significant amount of the traffic that is both intrastate and intraLATA should not be reserved to the monopoly carrier."[24] Yet this is precisely what has occurred.

According to the Huber Report, thirty-three states now prohibit interexchange carriers from competing in the intraLATA market. In addition,

> Facilities-based intraLATA competition is authorized in only thirteen of thirty-eight multi-LATA states and in only one of the eleven single-LATA states. Thirteen states have required interstate carriers either to block intraLATA traffic or pay a compensatory fee to the LEC in addition to access charges. . . . All have protected LEC rights to be the only carrier to which customers can presubscribe for their intraLATA toll service . . . . These regulations have . . . chilled competition in the intraLATA toll market. Huber Report at 3.15-3.16.

3. InterLATA Equal Access. The ability of the BOCs to undermine the equal access process is also evident from their approach to fulfilling their interLATA access obligations. The BOCs have failed to ensure that the competitive carriers obtain true equal access on an interLATA basis.

Despite the clear directive of the MFJ, equal access still is not a reality for these carriers even in those parts of the nation where end offices have been converted. Where equal access ostensibly has been achieved, severe problems continue to beset its actual implementation. The FCC has recognized that serious questions remain regarding whether competitive carriers are, in fact, receiving the same quality of access service provided to AT&T.[25] Furthermore, an undue proportion of calls by customers of competitive carriers are not routed to the proper carrier on a presubscription basis despite their customers' requests. In addition, competitive carriers do not receive adequate customer order information, a major factor in their successful participation in equal access conversions.[26]

The BOCs, at best, barely managed to meet the MFJ's September 1, 1986 deadline for converting "conforming" offices to provide equal access. DOJ has reported to the Court that most (but not all) "conforming" BOC end offices were converted to equal access by this date, and concluded that the BOCs are in "substantial compliance" with the equal access timetable. See Report of the United States to the Court Concerning the Status of Equal Access, filed October 31, 1986. However, MCI has strongly disputed even this conclusion. MCI has shown that DOJ failed to consider several unresolved equal access issues, such as the quality of the equal access provided and the BOCs' continuing practice of routing all sent-paid and collect calls made from public telephones to AT&T. See MCI Comments on the October 31, 1986 Report, filed January 9, 1987.

Nationwide, less than three of every four (72%) of BOC access lines have been converted. For some BOCs the percentage is considerably lower. NYNEX, for example, has only converted about 56% of its lines.[27/] This means that equal access, even in the most narrow, technical terms, is not available to interexchange competitors of AT&T in very substantial areas within BOC territories. There is no established deadline for conversion of nonconforming end offices. Until then equal access is not even nominally equal in many areas.

4. Centrex Service. Further indications of the BOCs' determination to thwart the efforts of competitors are evident from the manner in which they manipulate their control over Centrex facilities to benefit their own intraLATA services.

Centrex is one of the local telephone companies' principal services to businesses. It offers customers telephone company central office-based rather than customer premises-based switching facilities to originate and terminate traffic. Once a customer subscribes to Centrex, the service becomes a bottleneck which customers must use to communicate with interexchange carriers.

A number of BOCs apparently have refused to route intraLATA calls placed over their Centrex facilities to the customer's interexchange carrier of choice. For instance, in Michigan, where intraLATA competition is permitted, Michigan Bell reportedly refused to route customers' calls to Allnet, a competitive interexchange carrier, despite requests by Allnet customers to do so.[28/] In addition, MCI has reported that it is impossible to ascertain whether Pacific Bell's installations of Centrex presubscription orders have been accomplished correctly.[29]

COMPTEL does not believe that these Centrex cases are isolated instances but rather represent a consistent pattern of BOC leveraging of their local exchange market power. At a minimum, the Court should put the BOCs to the task of demonstrating that they have not refused to interconnect their Centrex facilities with interexchange facilities of competitive carriers.

5. WATS Access Lines. The BOCs have displayed similar anticompetitive behavior in resisting interexchange carrier requests to permit their customers to use WATS access lines on an intermixed basis for both intrastate and interstate calling. The necessity to separate their traffic to common points significantly increases the cost of their services.

The BOCs have defended this practice on the ground that the states involved prohibit intraLATA competition. In many instances, however, there is considerable doubt that the state in question has in fact barred intraLATA entry by others. As the FCC recently admonished the BOCs, absent definitive articulation by a state of a policy limiting the scope of intrastate competition, a BOC may not block intrastate WATS calls over WATS access lines.[30] Interexchange carriers now face the grinding task of challenging, tariff by tariff, interpretations of state policies asserted by BOCs as justifications for blocking and diverting to themselves intraLATA toll calls placed over WATS access lines.[31]

The BOCs also have imposed various additional restrictions on WATS access lines that have severely impaired their utility to competitive interexchange carriers. For instance, in May 1986 the FCC ordered several BOCs to remove from their tariffs various restrictions on the use of special access lines employed by competitive carriers to provide services which compete with AT&T's WATS service. The BOCs also were ordered to remove certain discriminatory tariff provisions which mandated restrictions, such as blocking, screening and limitations on directionality, that made WATS access lines virtually useless for interexchange carriers.[32] Notwithstanding the Commission's affirmance last December of its May 1986 Order,[33] several BOCs have only partially complied or have refused altogether to make unrestricted WATS access available to competitive interexchange carriers.[34/] Indeed, the Commission recently ordered these BOCs anew to remove these unlawful restrictions, and admonished one company that "[i]f it fails to do so as soon as practicable after the issuance of this Order we shall issue a Show Cause Order to examine whether penalties should be imposed as a result of [its] willful violation of Commission Orders."[35/]

6. Continued Cross-Subsidization. If the BOCs are permitted to engage in interexchange services, they could and undoubtedly would undermine the development of a competitive marketplace by cross-subsidizing their interLATA services as they have cross-subsidized other competitive ventures. Regional audits of the cost allocation practices of five BOCs conducted under the auspices of the National Association of Regulatory Utility Commissioners ("NARUC") demonstrate that the BOCs engage in widespread cross-subsidization.

For example, the Telecommunications Audit Branch of the California Public Utilities Commission found that the Pacific Telesis companies routinely engaged in cross-subsidization in the form of personnel transfers. The Audit Staff's report stated that "the PacTel Companies avoid costs associated with hiring, developing and training new employees when it [sic] transfers experienced Pacific Bell employees."[36/] The audit report concluded that "PacBell and its ratepayers were [not] adequately compensated for the value of the experts and managers permanently transferred or loaned to the affiliates . . . . This association may have a harmful effect" on PacBell ratepayers.[37/]

More recently, the California PUC staff reportedly has concluded that PacTel's regulated operating company contributed "technology and expertise without properly accounting for the cost under the MFJ." The staff concluded that "[h]ad PacBell accounted for these costs, general reduction of PacBell's overhead would have resulted." The staff has recommended that the PUC levy a five percent royalty on the gross income of PacTel's unregulated subsidiaries to be paid to the regulated operating company to compensate for PacTel's cross-subsidization schemes.[38/]

The Special Accounting Task Force of Southern Public Service Commissions reached similar conclusions. It found, among other things, that it is "practically impossible" for regulators to review the records of subsidiaries and divisions of BellSouth due to parent company protective agreements. The Task Force also concluded that BellSouth's "use of a ratemaking methodology to determine the percentage of revenues to be retained by BAPCO [its competitive directories and advertising unit], an unregulated subsidiary, is totally inequitable."[39/]

The NARUC Summary Report on the BOC regional audits put the case well:

> Questions remain as to the accounting separation of regulated and unregulated companies; RHC diversification and its effect on basic telephone service; and the commitment of the RHCs to maintaining basic service and abiding by the stipulations of the MFJ. Under these circumstances, it would be a major failure of public policy to abandon the telecommunications industry to 'competition' since there is no guarantee that the integrity of the system will be maintained.[40/]

In sum, the behavior of the BOCs since divestiture indeed confirms the wisdom of the MFJ's prohibition on their provision of interexchange services. In fiercely resisting competition in intraLATA communications, in failing to implement and fully provide equal access even for interLATA communications and in using a variety of tactics, including tariffing restrictions and cross-subsidization practices, the BOCs have sought to use their monopoly power to thwart the efforts of present and prospective competitors. Interexchange competitors of AT&T are still not receiving pervasive equal access for interLATA communications, and are not receiving any equal access for intraLATA communications. If the BOCs are permitted to enter the interLATA communications field, the Court must necessarily assume that, in light of their history after as well as before divestiture, the BOCs would have the incentive as well as ability to undermine if not destroy competition.

F. There are No Mechanisms That Could Prevent BOC Cross-Subsidization of Interexchange Services

The prohibition on BOC provision of interexchange services is grounded, in part, on the concern that the BOCs would be able to subsidize their interexchange services from their local exchange monopoly.[41] In recommending that the BOCs be permitted to provide out-of-region services and (under some circumstances) in-region services, the DOJ Report does not appear to be concerned that such cross-subsidization could occur,[42] nor does DOJ recognize the magnitude, and indeed the impossibility, of the task confronting the FCC and state public utility commissions in detecting and preventing such practices.

The DOJ Report seems to assume that if legal entry barriers to intraLATA competition were removed, the BOCs would not be able to engage in anticompetitive conduct in providing interLATA services. Instead, DOJ blithely asserts that "substanial risk of anticompetitive effect on the interexchange market could be contained effectively through regulatory controls." DOJ Report at 97-98. In fact, the BOCs would be able to engage in rampant cross-subsidization of their interLATA services even if regulatory restrictions on intraLATA services were removed, and this practice would profoundly undermine competition. There are no regulatory mechanisms in place or imaginable that could prevent the BOCs from leveraging their monopoly power in this manner. The BOCs could cross-subsidize their interLATA services to the detriment of competitors in a variety of ways.

There are no procedures prescribed or even under consideration by the FCC for identifying the cost of the access services that the BOCs would have to provide to themselves in furnishing interLATA service. The task of identifying these costs would be herculean if the BOCs furnished these services through the same corporate entity that provides all of their intrastate services and access services to interexchange carriers. Accordingly, there would be no way to prevent the BOCs from understating their own access costs by misallocating a portion of those costs to the monopoly access services they provide to their interLATA competitors.[43] This would have the pernicious result of allowing the BOCs to engage in predatory pricing by understating their own prices and inflating the costs and hence the prices of their competitors.

Cross-subsidization also could occur through the BOC's intrastate services absorbing the costs that should be associated with its interLATA services, whether interstate or intrastate. The jurisdictional separations process, prescribed by the FCC, instructs the telephone companies how to allocate costs between interstate and intrastate jurisdictions on a broad scale. It does not, however, provide a refined methodology that would allow the FCC and the states to detect whether BOC interLATA costs are being misassigned to the intrastate jurisdiction. That would require active policing by both the FCC and the states, a task well beyond their capabilities. Indeed, Dr. Huber labels the "two-tiered separations/allocations process . . . a product of Voodoo accounting." Huber Report at 3.33.

Cross-subsidization of interLATA intrastate services could also occur and would be beyond the ability of many state public service commissions to effectively detect and prevent. In the thirty-four multi-LATA states, the BOCs would be able to draw on their base of monopoly intraLATA revenues to subsidize their interLATA ventures. There are no state regulatory mechanisms in place that would permit the states to determine whether the BOCs are fairly allocating toll costs between their interLATA and intraLATA services and whether the monopoly intraLATA services are cross-subsidizing the new competitive ventures. It is evident, moreover, that the only tool the FCC has developed for detecting cross-subsidization of unregulated services would be inapposite.

In its attempt to minimize the danger that BOCs might engage in anticompetitive cross-subsidization of unregulated services from profits from monopoly local exchange service, DOJ relies heavily on a recent FCC Report and Order (the "Joint Cost Order").[44/] The Joint Cost Order prescribes revised standards for allocation of costs between regulated and unregulated activities that share facilities or personnel and for transactions between a regulated company and its corporate affiliates.

DOJ issued its Report, relying in part on these new standards, before the Commission had even released the text of its decision.[45/] Nonetheless, DOJ confidently states that under the FCC's Joint Cost Order "[c]osts are to be assigned and allocated in a manner that will minimize the risks that a BOC will be able to impair competition in unregulated markets by misallocating costs to regulated basic services." DOJ Report at 32.

DOJ's confidence that the FCC's latest effort to separate costs of regulated telephone service from the costs of unregulated activities will finally be successful has no evident foundation. FCC attempts to prevent telephone company cross-subsidization through various cost allocation methods have had a long and thoroughly undistinguished history.

For example, the Joint Cost Order itself recounts the Commission's failure in Docket 18128.[46/] The Commission "never succeeded in actually using [its] preferred method to determine lawful rates for AT&T's services" due to "the massiveness and complexity of the data generated by AT&T's procedures" and to "the extreme fungibility of the plant and . . . the high degree of substitutability amongst the services."[47/] Indeed, the Commission has never been able to develop a satisfactory methodology for reasonably allocating common costs among multiple basic services.[48/] The Joint Cost procedures separate costs on the basis of technical distinctions between vertical services, basic and enhanced. They are not designed to separate common costs among horizontal services, viz. local exchange, intraLATA and interLATA interexchange services.

Moreover, the Joint Cost approach allocates common costs primarily on the basis of an all too familiar technique that depends upon the reliability of projections of relative use. Projections in an industry as dynamic as telecommunications are rather difficult to verify. They are tailor-made for manipulation, and because they are only projections it is virtually impossible to demonstrate that they are in error, much less that the error was deliberate.

Significantly, the new and detailed cost allocation manuals to be required under the Joint Cost Order have not yet even been submitted by the BOCs, much less approved by the Commission. Indeed, these manuals need not even be filed by the BOCs until September 1, 1987.[49/] Successful implementation of the FCC's new procedures depends far more on these manuals than on the mere establishment of revised cost allocation guidelines by the regulatory agency. At this time, with the BOCs' revised manuals an unknown quantity, it is clearly premature to assume that the transition to the new cost allocation procedures prescribed in the Joint Cost Order will be trouble-free or that the procedures will be workable and effective.

Further, it is obvious that the success of the FCC's Joint Cost procedures in deterring BOC cross-subsidization will require active monitoring and close scrutiny by the FCC, as well as by state regulatory authorities. It is unclear where either will find the staff and resources to adequately perform this function.

State regulatory authorities are notoriously understaffed and underfinanced to closely monitor BOC cost allocation activities. Some have even evinced a disinclination to try. See Huber at 3.53-3.54. At the federal level, the FCC's proposed budget for fiscal year 1988 actually proposes decreases in the Common Carrier Bureau's auditing capability. As FCC Chairman Mark S. Fowler recently testified before Congress in presenting the Commission's 1988 budget:

> This budget request includes a program decrease of three positions and $132,000 in the Common Carrier Activity. As the regulated telephone companies provide us with independent detailed audits of their operations, we believe we can eliminate one of the audit teams we presently have without adversely affecting our regulatory responsibilities.[50]

DOJ's optimism that new FCC cost allocation procedures will minimize the opportunity for BOCs to cross-subsidize unregulated ventures is further belied by the Department's own assessment that the "BOCs' opportunities for discrimination and cross-subsidization still exist," DOJ Report at 5. Dr. Huber is more pointed and far less generous. He states: "The regulatory history of separating costs between local and interexchange businesses is one of rampant and often deliberate cross-subsidization, blessed if not actually required by various regulatory bodies." Huber Report at 3.53. Dr. Huber goes on to observe that "[w]hat emerges from this regulatory Cuisinart" of cost separation "is often interesting but always a surprise." There are layers upon layers of arbitrary cost division and each division inevitably involves substantial discretion:

> After four or five cuts, discretion has been raised to the fourth or fifth order. If there is 20 percent discretion as to just where each cost cut will be made, there is 250 percent discretion as to the size of each small piece that finally emerges. Id. at 3.54.

The MFJ recognized the FCC's past failures in enforcing behavioral restraints. The Court noted the testimony of former FCC Common Carrier Bureau chiefs that the Commission "never has been capable of effective enforcement of the laws governing AT&T's behavior," and found that "the problems of supervision by a relatively poorly-financed, poorly-staffed government agency over a gigantic corporation . . . are no more likely to be overcome in the future than they would be in the past." MFJ, 552 F. Supp. at 168.

It is clear, then, that there are no nonstructural safeguards that the FCC has yet devised or is likely to conceive that could prevent the BOCs from improperly shifting costs from local exchange and intraLATA services to competitive interexchange services.

G. There Are in Any Event No Pro-Competitive Benefits of BOC Entry Into the Interexchange Market

The DOJ Report is virtually silent on any alleged pro-competitive benefit of easing the interexchange restrictions. To the contrary, DOJ admits, albeit rather grudgingly, that:

> the difficulties currently experienced by carriers attempting to compete with AT&T do not, in themselves, warrant the conclusion that BOC entry would provide an affirmative benefit to interexchange competition that would outweigh substantial risks of discrimination or cross-subsidization . . . . In these circumstances, it would be premature to conclude at this early point in the evolution of the interexchange market that it is essential to allow the BOCs to enter interexchange service across the board, notwithstanding risks of anticompetitive conduct, in order to provide competition to AT&T.[51]

This conclusion accords with the Court's findings[52] and with marketplace reality. There is vigorous competition throughout much of the interexchange market. Dr. Huber concludes, for instance, that "[c]ompetition in the provision of interLATA services to many large urban markets apparently remains vigorous" and that "[o]verall, the interexchange market is quite competitive today, in at least some markets."[53]

The DOJ Report contends, all too facilely, that "entry barriers in the interexchange market are high." DOJ Report at 66. Although new entry on a broad-based national scale as a facilities-based carrier is difficult and would require large capital outlays, the marketplace has demonstrated that entry as a regional or local facilities-based carrier or as a reseller nationally or locally is feasible for many knowlegeable entrepreneurs. Current estimates are that there are some 516 carriers, both facilities-based and resellers, providing interexchange services in one or more areas of the country.[54/]

The recent consolidations among national carriers have strengthened, not diminished, the vigor of competition to AT&T in this market segment.[55/] Effective competition across all market segments is increasing and promises to continue to do so, not only without BOC entry, but precisely because the BOCs are barred.

Moreover, DOJ fails to suggest much less demonstrate that any efficiencies would flow from BOC entry into interexchange services in areas where they have no existing facilities or organizational structure. In fact, the Court concluded that BOC interexchange services would be more than marginally profitable only if they subsidized those services from local exchange profits:

> If the Operating Companies entered the interexchange market and competed fairly, without exploiting their local monopoly positions, the resulting increase in competition would not be substantial. Moreover, the Operating Companies could realistically recoup substantial profits from their interexchange operations only by using their monopoly power to disadvantage competitors.

MFJ at 189. See also id. at 224.

DOJ has shown no compelling need for BOC entry into the interexchange services market. There certainly is no need to hype BOC revenues. BOC profits are more than robust: each of them earned profits of between $950 million and $1.7 billion in 1986.[56/] True efficiencies that might lead to lower consumer costs are unlikely, particularly for out-of-region services, while cross-subsidization and discriminatory behavior are distinct possibilities. And finally, the interexchange market, by DOJ's own admission, does not need BOC entry to discipline AT&T's prices.

* * *

In sum, all available evidence, including the findings of the Huber Report upon which DOJ relies, indicates that while prospects for future inroads into the BOCs' bottleneck local exchange monopolies may be promising, those bottlenecks are still intact. The BOCs continue to have the ability and incentive to wield their monopoly power to cross-subsidize competitive activities to the detriment of ratepayers. In short, the changed conditions described in the MFJ and subsequent decisions in this proceeding that might justify elimination of the interexchange prohibition have not yet occurred. The interexchange prohibitions should and must be retained.

IV. NO JUSTIFICATION EXISTS FOR REMOVING THE MFJ PROHIBITION ON IN-REGION INTEREXCHANGE SERVICES BY BOCs SIMPLY UPON "REMOVAL OF REGULATORY BARRIERS TO COMPETITIVE ENTRY"

The DOJ recommendation that the BOCs should be permitted to offer interexchange service within their own local service regions merely upon a showing that "all regulatory barriers to entry and resale in exchange telecommunications service have been removed in particular exchange areas within its region," DOJ Report at 7, is naive, contradicted by DOJ's own findings, and refuted conclusively by a realistic assessment of barriers to entry in the local exchange.

The DOJ Report expressly acknowledges that the BOCs have "significant opportunities for anticompetitive conduct" within their local exchange regions. DOJ Report at 78-80. They "clearly would have the incentive to favor their own interexchange services, and the complexities of current access charge pricing rules may make such discrimination difficult to detect." Id. at 92-93. Moreover, "the existence of intraLATA toll monopolies and the complexities of access pricing also give rise to opportunities for anticompetitive cross-subsidization." Id. at 93. Furthermore, the BOCs could readily wield their market power to discriminate against competitive carriers in allowing access to customer and market information, technical quality of access, and access to network information. Id. at 94-96.

Despite its recognition of these formidable barriers to entry, DOJ blithely assumes that the mere elimination of "legal barriers" to local exchange competition would dissolve a BOC's market power in an exchange area. Id. at 101. Based upon this seemingly facile predicate DOJ recommends elimination of the BOC interexchange prohibition, even as to in-region exchange areas, once "there are no [regulatory] restrictions on either facilities-based intraLATA competition or on resale (or sharing) of BOC services." Id. at 98. DOJ would allow such in-region interexchange service by a BOC "even if a residual core of local exchange service remains a natural monopoly at that time." Id. Thus, DOJ would not require that any degree of competition exist as a precondition to elimination of the interexchange prohibition, but only the removal of formal legal/regulatory entry barriers.

DOJ's recommendation must be rejected. It is based on the patently false premise that legal entry barriers are the only bar to the development of a competitive marketplace. To the contrary, a BOC's bottleneck monopoly is not sustained even principally by governmental entry barriers. As DOJ's reference to a BOC "natural monopoly" suggests, a de facto monopoly may exist irrespective of the presence of a de jure monopoly. There are a number of other entry barriers, including the extremely capital-intensive nature of local transmission and switching facilities, the difficulty of obtaining local rights of way, and entrenched tariff restrictions.

One demonstration of the existence of these other barriers is the absence of effective competition even in those states which nominally allow entry. The DOJ and Huber Reports state that facilities-based intraLATA competition is presently authorized in 14 states,[57/] but neither asserts that intraLATA competition exists to any substantial degree in any of these states. It is apparent that even in these 14 states that may meet the DOJ criteria, there is little if any effective competition to the local exchange carriers. In Minnesota, for instance, intraLATA interexchange entry was permitted almost a year and a half ago[58/] and yet there are no alternative intraLATA services of any note.[59/] Indeed, DOJ concedes that it "cannot say how quickly alternative [local exchange] systems would grow" if formal regulatory constraints on intraLATA competition are eliminated. DOJ Report at 97.

Second, it is the BOC itself, and not merely local regulators, that perpetuates and protects its local exchange monopoly. See, e.g. Huber Report at 3.15 n.54. Although federal and state regulators can and do prescribe tariff provisions following hearings, the statutory schemes depend in the first instance, and often in the final, upon BOC initiative.[60/] In the normal course of events the BOC proposes and the regulatory agency reacts. This scheme grants wide latitude to the BOCs, and they take full advantage of it.

For example, BOCs frequently incorporate restrictive tariff provisions in their state tariffs which have the effect of limiting resale of local exchange service or allowing the BOC to charge higher rates for service obtained for resale. See DOJ Report at 90. The DOJ Report lumps onerous BOC tariff provisions together with restrictive state "laws and regulations," failing to recognize that the former category of restrictions are often the creation of the BOCs themselves. Removal of such restrictions would require not only the elimination of regulatory barriers to entry, but affirmative action by state authorities to prevent the BOCs themselves from erecting and maintaining tariff barriers to local competition. This, however, DOJ would not require, and it is unlikely that state regulators would have the resources, or in some cases the inclination, to take affirmative steps to remove tariff entry barriers.

Third, there frequently are insuperable technological barriers to entry of potential new competitors in the local exchange market. For example, it may be possible to employ radio-based technologies such as DTS in smaller communities where spectrum congestion would not be a problem. The radio spectrum in larger metropolitan areas, however, is too congested and the amount of intraexchange traffic too great to enable a new entrant to base alternative facilities upon radio rather than wire technologies. The NTIA Report notes, for instance, that DTS growth has been severely hampered due to the fact that each operator is licensed to use only a limited amount of spectrum in a particular geographic area, thereby placing a ceiling on the volume of local service that can be provided. DTS is also hindered by high subscriber equipment costs: receiving equipment at a subscriber location costs about $10,000, and is economical only for a large volume of traffic. See NTIA Report at 46.

On the other hand, the availability and cost of rights-of-way frequently is an equally serious barrier to entry by means of wire-based systems. Wired transmission systems must use either poles or underground conduits. These supporting structures are rarely if ever owned by the municipality, but usually are the property of an existing utility. The utility often is not eager to allow new competitors to share their poles or conduits.

The NTIA Report noted, for instance, that one fiber optic network operator consumed four years to secure conduit space from the local exchange carrier at satisfactory rates. NTIA also gave the examples of one DTS operator who must pay 40 percent of its revenues for space for its transmission equipment (so-called "roof rights") in two major metropolitan area, and of another DTS operator who was denied access to a choice roof site in another large city. See NTIA Report at 46. Indeed, in the case of cable television systems, it became necessary for Congress to pass a law to ensure the right of cable operators to use existing utility poles at reasonable rates.[61]

Fourth, DOJ's condition precedent to allowing in-region interexchange service offerings by the BOCs is not only too permissive, it is also hopelessly vague. There is a wide range of state regulations which inhibit, while not formally prohibiting, competitive entry into local exchange markets. The NTIA Report observed: "Even where competitive entry is legally permitted, it may not occur if new entrants face state regulation of their services. The FCC has pointed out, for example, that the threat of rate regulation may deter firms from offering new services."[62]

Almost any state regulation affecting a potential new entrant could be said to constitute an entry "barrier." At the most innocuous end of the continuum are bureaucratic requirements of registration of new entrants that in some cases are ministerial but in others introduce at least significant regulatory lag and accompanying opportunity costs, and often substantial expenses. Registration and similar barriers will continue to exist even in the face of permitted entry. As long as a potential entrant must await affirmative state action before commencing installation or operation, there will be an entry barrier that in a given case could be administered so as to become a major barrier.

DOJ apparently recognizes the potential obstacles from such barriers by excepting "modest" certification requirements.[63] DOJ fails, however, to adequately account for the difficulty in defining "modest," much less in policing the *in situ* application of a "modest" requirement.

Moreover, the new entrant would have to cope with a plethora of additional regulations, such as financial qualifications, quality of service regulations and filing requirements, as well as a wide array of technical regulations. Such regulations frequently have been crafted to fit the incumbent local exchange carrier's operations and procedures. When applied to new entrants with different procedures and employing different technologies, such regulations could pose serious barriers to entry.

Indeed, the incumbent BOC has the significant advantage of a wealth of regulatory expertise developed over years of monopoly service at ratepayers' expense. A potential new entrant would be starting at square one in attempting to understand and comply with regulatory regimes that have been made to order for the incumbent monopoly provider. It is evident that, in the real regulatory world, the difficulty of effectively and fairly distinguishing an entry or service "regulation" from an entry "barrier" would be insurmountable.

Fifth, a potential new entrant could well be halted at the starting gate by legal challenges on the part of the incumbent

BOC local exchange service provider. The threat of legal challenges, either as to permissibility of service or as to possible economic regulation, pose substantial barriers to entry. Even if success seems highly likely, the legal fight is costly, and is an investment that usually must be made before any revenues can be assured, much less collected. The need for such legal investments reduces the probability of profitable service later, and thus deters firms from entering.

Sixth, especially with regard to residential customers, it may simply be unreasonable to expect end users to subscribe to more than one local telephone service and to have multiple lines entering their homes. Because subscribers typically will opt for a single service provider, the removal of legal barriers will not result in local exchange competition in practice. Interconnection of competitive local services may be feasible in theory, but a BOC's competitor will still have to depend on BOC special access lines. Moreover, the present-day example of interconnected telex services demonstrates that the cost of sending a message from one network to another exceeds the cost of sending the same message from one terminal to another in the same network.

Finally, it should by now be clear that neither the states nor the FCC can effectively prevent anticompetitive behavior by an entrenched local service monopolist against a fledgling competitor. As discussed in a previous section, there is an ample body of evidence of the failure of regulatory safeguards to effectively deter past and current discrimination and cross-subsidization.

As this Court stated in adopting the MFJ:

> The Court cannot accept the proposition advanced by some that state and federal regulation alone will eliminate the possibility of anticompetitive abuses by the Operating Companies. If regulation could effectively prevent these practices, there would have been no need for the AT&T action.[64]

Significantly, during the Tunney Act proceedings prior to final adoption of the MFJ, the Department itself stated that if BOCs were permitted to enter competitive markets through separate subsidiaries, "the BOCs would retain the ability to cross-subsidize competitive offerings through the allocation of costs shared by the BOC and its subsidiary, a problem that has evaded regulatory solution, despite substantial effort, for over 20 years."[65] In light of these recent pronouncements by the Department, it is truly extraordinary that it can now find that "substantial risk of anticompetitive effect on the interexchange market could be contained effectively through regulatory controls." DOJ Report at 97-98.

Indeed, while the DOJ Report asserts that the FCC could be relied upon to deter monopoly local exchange carriers from engaging in anticompetitive discrimination and cross-subsidization of interexchange services,[66] the FCC actually is proposing to decrease its common carrier auditing activities, limiting further its capacity to monitor carriers' activities and detect competitive abuses. See supra p. 31. The FCC, in turn, has often placed reliance on DOJ enforcement of the antitrust laws to deter anticompetitive behavior.

The DOJ Report suggests that the Court could "fashion conditions that provide the BOCs with an incentive to remove restrictive tariff provisions not mandated by the states." DOJ Report at 103. DOJ does not, however, condition its recommendation to permit BOC in-region interexchange service upon removal of such restrictive tariff provisions by the BOC. DOJ's failure to insist upon removal of such nonregulatory entry barriers as a condition precedent to in-region interexchange services reveals the depth of the Department's policy predilection to unleash the BOCs from the MFJ's interexchange prohibition whether or not actual, as opposed to theoretical, opportunities for competitive entry to the local exchange market exist.

V. THE DOJ REPORT PROVIDES NO DEFENSIBLE JUSTIFICATION FOR ALLOWING THE BOCs TO PROVIDE OUT-OF-REGION INTEREXCHANGE SERVICES

The DOJ Report also recommends that the BOCs be permitted immediately to provide "out-of-region" interexchange services without limitation -- this despite DOJ's recognition that "clearly, it will not be easy to measure the risk to competition of the BOCs' entry into markets now closed to them by the decree or to predict the success of regulatory controls in further limiting those risks." DOJ Report at 52. Nevertheless, the Department finds it "unlikely" that BOC interexchange services would have anticompetitive consequences if their interexchange activities are geographically separate from their local exchange areas.

The Court in adopting the MFJ could have permitted such "out-of-region" interexchange services by BOCs on the same theory that the DOJ Report urges today, but it did not. Instead, the MFJ instituted a nationwide prohibition because it recognized "the substantial risk that the Operating Companies will use the same anticompetitive techniques used by AT&T in order to thwart the growth of their own competitors." MFJ, 552 F. Supp. at 224.

Among the dangers foreseen by the Court in permitting the BOCs to provide interexchange services was the BOCs' "ability to subsidize their interexchange prices with profits earned from their monopoly services." Id. at 188. Cross-subsidization, in the form of either misallocation of common costs or the transfer of monopoly revenues to competitive enterprises, is possible to a significant extent even if the competitive service is performed out of the area in which the monopoly activity takes place. These activities will have the same kinds of deleterious effects both on competition and on ratepayers.

The DOJ Report implies that a nationwide BOC interexchange prohibition was thought necessary at the time of the adoption of the MFJ (but no longer is necessary) because a single BOC holding company was envisioned rather than the seven that exist today. See DOJ Report at 72. This assertion by the Department is groundless for several reasons. First, DOJ concedes that the plan to create seven independent regional holding companies was developed before the decree was entered. Id. In addition, in adopting the MFJ, the Court clearly contemplated the "amalgamation of the twenty-two Operating Companies into seven regional holding companies." MFJ, 552 F. Supp. at 142 n.41.

DOJ also bottoms its change of heart on the supposition that "while the BOCs share a common background and have some common interests . . ., they have become independent companies, willing and able to compete against each other." DOJ Report at 74-75.

DOJ supports this belief with nothing more than several anecdotal references. A few examples of limited competition hardly constitute sufficient evidence to trigger abandonment of the extra-region restriction. Furthermore, it does not follow from the fact that there is some apparent competition among BOCs in non-local exchange businesses that they will not actively collude or consciously parallel each other's conduct to the disadvantage of competitive interexchange service providers.

There is, in any event, evidence that the BOCs' ardor to compete in each other's territories may be receding.[67/] Some of the losses from their "feeding frenzy" have been staggering. U.S. West, for example, reportedly took a pre-tax charge of some $100 million for extra-region activities.[68/]

Moreover, the extra-region services the BOCs have entered to date have required a considerably smaller capital investment than interexchange entry would entail. The risk of failure has therefore been substantially lower. Consequently, the need to segment the market or unite against a common competitor has not been nearly as great. In short, the apparent competitiveness among BOCs in some non-core businesses cannot be considered a reliable predictor of future behavior in interexchange services. It certainly provides no assurance that the BOCs would not, individually or in concert, apply their market power to out-of-region interexchange services in ways that will harm competitive, non-BOC interexchange service providers.

DOJ's theory that BOC provision of out-of-region interexchange services would be free of anticompetitive risk merely because "outside of its region a BOC does not control any local exchange bottlenecks," DOJ Report at 72, is simplistic. Among other problems, opportunities will exist for collusion and cooperative arrangements between and among BOCs to hinder their interexchange competitors. The BOCs' cooperative participation in Bellcore, for example, creates a ready vehicle for them to exchange information and implement interexchange service strategies to the disadvantage of competitive interexchange service providers. The BOCs "express their interests, their views, what they will support," primarily through the Bellcore councils.[69/]

Information exchanges through these councils and at other meetings can facilitate tacit or express collusion. This "inside track" is unavailable to competitive interexchange providers. More importantly, the planning, developing and testing functions of Bellcore offer a tailor-made guise for the BOCs to collaborate on ways to disadvantage their interexchange competitors.

The DOJ Report does acknowledge the anticompetitive potential in Bellcore. Consequently, DOJ concludes that "[i]f the BOCs are permitted to provide interexchange service, . . . Bellcore's role must be confined to activities that would not provide a vehicle for concerted discrimination by the BOCs." DOJ Report at 75. However, DOJ offers no advice as to how this could be accomplished or enforced. Instead, DOJ merely notes that the Sherman Act would prohibit anticompetitive reciprocal discrimination agreements against interexchange rivals. Id. at n.152.

BOC collaboration also would be facilitated by the personal and corporate loyalties of those involved. Many of the current personnel of the BOCs are former employees of the integrated Bell System. There continue to be significant personnel transfers among the BOCs' regulated monopoly operations and their competitive businesses and between the BOCs and Bellcore.[70] These historical corporate and continuing personal relationships would facilitate the creation and enforcement of "common guidelines" to benefit the BOCs' own interexchange operations and to place competitors at a disadvantage.

The BOCs also could collude through their control over common credit card and billing systems. The credit card system allows customers of one BOC to use its credit card in another BOC's region for intraLATA calls or interLATA calls placed with AT&T. This mutual assistance system is a significant marketing tool. Other interexchange carriers do not participate in this system, although it is possible that they may do so by purchasing billing and collection services from the BOCs. However, because the FCC has detariffed billing and collection services,[71] there is no way to assure that the BOCs would provide these services in a non-discriminatory fashion and under reasonable rates and conditions to other interexchange carriers. The BOCs thus could provide credit card services to one another on a preferential basis relative to other interexchange carriers.

In addition to their opportunity to collude to enforce discriminatory practices against common competitors, the BOCs will retain some ability to subsidize out-of-region interexchange offerings with monopoly profits from local exchange service. For example, the avoidance of costs associated with hiring, developing and training new employees when a BOC transfers experienced employees, cited in the California PUC Audit Staff's report on PacTel, see supra, pp. 23-24, can occur whether the transfers are in-region or out-of-region. DOJ's assertion that "[t]he opportunity for misallocation of such costs would be significantly less with regard to services outside a BOC's region because of the likely geographic separation of facilities and personnel," DOJ Report at 76, is conclusory. DOJ recognizes that there is some threat of anticompetitive misallocations of costs, but dismisses its importance on the strength of unsupported assertions. The Court and the public deserve more.

Finally, a BOC may have the ability and incentive to wield its monopoly power to discriminate within its own region against an interexchange carrier with whom it competes in other regions. In-region discriminations by BOCs, such as those with respect to interconnections and access discussed in Section III.E above, could have a serious cumulative effect on non-BOC interexchange service competitors if engaged in by several BOCs. Moreover, the BOCs already have access to a wealth of proprietary information and research and development which interexchange carriers have provided in the course of arranging interfaces to local exchanges. The BOCs would be able to readily apply this information to their own out-of-region interexchange services without remuneration to the competitive interexchange providers. As the Huber Report explains: "As competing interexchange carriers, LECs might be positioned to misuse this sensitive advance knowledge." Huber Report at 3.21. If a BOC interexchange subsidiary gained access to this proprietory information it would, as the Huber Report concludes, "gain a significant jump over its competitors." Id.

In short, the mere geographic separation of BOC interexchange services from their local exchange bottleneck areas will not deprive the BOCs of the ability to use their regional monopolies to gain unfair advantages in out-of-region interexchange service markets.[72]

VI. REMOVAL OF THE BOC INTEREXCHANGE PROHIBITIONS COULD RESULT IN HARM TO UNIVERSAL TELEPHONE SERVICE

As noted previously, a primary reason underlying the MFJ's prohibition on the provision of interexchange services by BOCs was the fear that if the BOCs provided competitive interexchange service in addition to monopoly local exchange service, they might subsidize their interexchange prices with profits earned from their monopoly services to the detriment of local ratepayers. MFJ, 552 F. Supp. at 188. Subsequently, when shortly after the effective date of the MFJ the BOCs sought blanket line of business waivers to engage in numerous activities other than local telephone service, including interexchange services, the Court elaborated upon the importance of the MFJ restrictions:

> Under the decree, the Regional Holding Companies play an essential role -- they are to provide efficient, economical, and, if possible, technologically advanced local telephone service. Their role is not to provide a source of ratepayer funds, credit, and other assets to finance competitive ventures, nor were they meant to be vast conglomerates in which telephone service is relegated to a subordinate place.

The Court went on the state that if the BOCs were to neglect their local exchange responsibilities in order to pursue other business objectives, "the public, unable to go elsewhere, will suffer in higher rates, deteriorating service, or both. Such a result would be entirely inconsistent with the basic purposes of the decree . . . ."[73] Again, when the BOCs last year asked for "clarification" of the decree to permit them to provide a range of non-local exchange services, the Court expressed concern that "their relative lack of interest in basic telephone service [indicates] that an ascent into the ranks of conglomerate America rates far higher on their list of priorities than the provision of the best and least costly local telephone service to the American public."[74]

Thus, as the Court has recognized, there is a substantial risk that BOC entry into the interexchange market would drain revenues needed to maintain the quality of local telephone service. The DOJ Report does not even address this risk to universal service, much less alleviate the Court's well-founded concerns.

VII. CONCLUSION

The prevalent theme running throughout the DOJ Report is that the prohibition on BOC provision of interexchange services should be substantially emasculated because the risk of anticompetitive behavior by the BOCs is low, and that regulatory oversight or the antitrust laws can correct abuses that do develop. This simplistic conclusion is not based upon either sound analysis or marketplace facts.

The BOCs indisputably continue to have bottleneck control over virtually all segments of local exchange communications. DOJ admits this, and Dr. Huber proves it. DOJ's belief that the removal of regulatory barriers to intraLATA entry will *ipso facto* diminish the BOCs' market power not only betrays a naive understanding of the welter of regulatory barriers, it ignores the host of other well-documented barriers that in the aggregate are formidable, from heavy capital requirements for some entry to the frequent unavailability of necessary rights of way.

Equally naive is DOJ's proclaimed faith in the regulatory process or the antitrust laws as prophylactics. The FCC's latest effort at an anti-cross-subsidization device is far from complete, still to be tested and, in any event, a barely disguised rehash of two decades of failure. No amount of declaiming of success by FCC officials can overcome the presumption of their past record in producing effective cost allocation manuals. The states' record is no better, and their resources far less. The federal and state regulatory processes' failure to measure up in the past is demonstrably prophetic. As for the antitrust laws, having wrenched the fabric of the telecommunications industry to reach this point, it is passing strange to suggest a return to square one.

DOJ also fails to adduce a single countervailing rationale to substantially undercut the capstone of the MFJ after only three years. There is in fact no need to unleash the BOCs, to improve either their economic health or the competitive health of the industry. The real dangers, whether extra-region or in-region, far outweigh the speculative, unstated benefits.

In light of the foregoing, COMPTEL respectfully submits that the DOJ Report's recommendations with respect to BOC provision of interexchange telecommunications services should be rejected.

Respectfully submitted,

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March 13, 1987

ENDNOTES

1/ Limited intervenor status was granted by Order dated February 26, 1987.

2/ Unless otherwise indicated, we will adopt the DOJ Report's practice (DOJ Report at n.1) of using the term "BOCs" to refer to both the 22 divested Bell Operating Companies and to their parents, the seven regional holding companies ("RHCs").

3/ United States v. American Tel. & Tel. Co., 552 F.Supp. 131 (D.D.C. 1982), *aff'd mem. sub nom.* Maryland v. United States, 460 U.S. 1001 (1983).

4/ United States v. Western Electric Co., 592 F. Supp. 846, 868 (D.D.C. 1984) (emphasis added). *See also* United States v. Western Electric Co., 627 F. Supp. 1090, 1098 n.26 (D.D.C. 1986). The court repeated its holding in the MFJ (552 F. Supp. at 195) that "the removal of the restrictions should be governed by the same standard which the court has applied in determining whether they are required in the first instance," 592 F. supp. at 852, and made clear that is would apply the same standard for waiver of an MFJ restriction that it had established for removal of the restriction. *See id*. at 851, 855 n.21, 860, 868-69.

5/ Dr. Peter W. Huber, *The Geodesic Network: 1987 Report on Competition in the Telephone Industry* (January 1987).

6/ DOJ Report at 57.

7/ *See* 592 F. Supp. at 855 ("the burden was placed on the Operating Companies to demonstrate the absence of an anticompetitive effect"). *See also* United States v. United Shoe Machinery Corp., 391 U.S. 244, 248 (a consent decree "may *not* be changed in the interests of the defendants if the purposes of the litigation as incorporated in the decree (the elimination of monopoly and restrictive practices) have not been fully achieved").

8/ DOJ Report at 42, *citing* Huber Report at 2.12, 2.23, 2.25.

9/ *Id*., *citing* Huber Report at 1.8, 2.12. 2.23.

10/ *Id*. at 80, *citing* Huber Report at 3.9 Table IX.5.

11/ *See* NTIA, "Issues in Domestic Telecommunications: Directions for National Policy," NTIA Spec. Pub. 85-16, July 1985, *especially* at p. 177.

12/ *See* Huber Report at 1.22, 3.15.

13/ The Court held, however, that it "lack[ed] the authority to require the opening-up of states and LATAs to internal competition over the objections of the states and their regulatory agencies." 569 F. Supp. at 1005.

14/ Huber Report at 3.15 n.54, *citing* *Communications Week*, Mar. 26, 1984.

15/ *Id*. at 3.15-3.16. Huber notes that California expressly prohibited intraLATA competition by interexchange carriers as recently as June 1984 -- within three months of the above-referenced reports. *Id*. at 3.15.

16/ *Id*. at 3.16.

17/ The assumption that the building blocks for competition "are falling into place" overstates present trends and overlooks a critical component of the bottleneck. For example, Dr. Huber treats private branch exchanges (PBXs) as a new phenomenon that will reduce or eliminate the local exchange bottleneck; however, PBXs were in existence and taken into account by the Court in 1981, prior to its adoption of the MFJ. *See* 524 F. Supp. 1336, 1348-50 (D.D.C. 1981).

More fundamentally, his "geodesic dome" model seems to assume that local exchange bottlenecks are withering away as switches become "smarter," less expensive and more widely dispersed. However, even as this occurs, the local exchange carriers -- the BOCs -- continue to control the other critical component of the bottleneck, *i.e.*, the transmission lines. The Huber model does not appear to recognize that even if regulatory barriers to independent transmission capacity are removed, it will be exceedingly difficult for potential local exchange competitors to create alternate transmission paths, especially in urban areas.

Among other things, radio spectrum is already extremely congested, *see*, *e.g.*, NTIA Report at 28. It does not present a practical alternative for multipoint, high volume transmission capacity. Moreover, public rights of way for new transmission lines will often be difficult or impossible to obtain. *Id.* at 46. Perhaps most importantly, installation of new transmission capacity would require enormous amounts of capital for what would be largely duplicative facilities. *Id.* at 48. *See* *infra* pp. 40-45. In short, notwithstanding the purported migration of the network from a pyramidal to a geodesic model, the local exchange bottleneck with respect to transmission lines will continue to exist indefinitely.

18/ *Telecommunications Reports*, Jan. 19, 1987 at 9 (interview with Albert Halprin). Indeed, Mr. Halprin admitted in the context of possible modification of the MFJ's interexchange prohibitions that marketplace changes "'have not been that dramatic,'" but he contended instead "that the theory of the decree was 'wrong in the first place.'" *Id.* at 7.

19/ This language in the MFJ suggests that a BOC, not DOJ, is to present this showing, accompanied by specific references to its own particular circumstances and competitive conditions in the market the BOC wishes to enter -- that is, the Court envisioned an *ad hoc* review of whether a particular BOC may be excused from the restriction, rather than a blanket elimination applicable to all BOCs.

20/ *See* *Communications Week* ("Forum"), Feb. 16, 1987 at 13-16.

21/ The Court required the BOCs to file written commitments that they would provide intraLATA access to interexchange carriers "equal in technical quality to the access provided to those carriers for interLATA calls," 569 F. Supp. at 1107-08. This commitment was to be waived if a BOC "is affirmatively prohibited from granting such access by a command of a state regulatory body." *Id.* at 1006 n.74. As Dr. Huber observes, "[t]oday, the exception is usually the rule," due to a very major degree to BOC lobbying of their state regulators. *Id.* *See* Huber Report at 3.15 and n.54.

22/ *See* *supra* note 20. "Feature Group D" service is supposed to provide 1+ dialing to a presubscribed carrier. *See* Midyear 1986 Access Tariff Filings (Reconsideration), FCC 86-535, rel. Dec. 19, 1986 at n.26. Since the BOCs do not provide presubscription for intraLATA toll calling, however, they have preordained the result that 1+ dialing is unavailable to customers of competitive carriers.

23/ *See* *supra* note 20.

24/ 569 F. Supp. at 1005.

25/ Investigation Into the Quality of Equal Access Services, FCC 86-248, rel. May 23, 1986, ¶ 132.

26/ *See* Complaint of U.S. Telecom, Inc., File No. ENF-86-13, filed May 16, 1986.

27/ Huber Report at Table IX.7.

28/ *See* *supra* note 20.

29/ *See* MCI Comments, *supra* p. 19, at Exhibit A.

30/ *See, e.g.*, Midyear 1986 Access Tariff Filings, Mimeo No. 4621, released May 20, 1986, Mimeo No. 4867, released May 30, 1986; Order, DA 86-425, released January 6, 1987.

31/ *See, e.g.*, Memorandum Opinion and Order, Mimeo No. 2199, rel. March 6, 1987.

32/ Midyear 1986 Access Tariff Filings, Mimeo 4621, rel. May 20, 1986. The Commission concluded that "the attempt by certain LECs to establish separate rates, separate rate structures and separate use restrictions applicable to WATS closed ends is unlawful," and ordered them to file revised special access tariffs by June 1, 1986 which would correct the rate inequities and "eliminate all discriminatory restrictions applying only to WATS access lines and not to all voice grade special access lines." *Id.* at ¶¶ 10, 14.

33/ Midyear 1986 Access Tariff Filings, 61 RR 2d 1311 (rel. Dec. 19, 1986).

34/ *See* Memorandum Opinion and Order, Mimeo 2199, rel. March 6, 1987. *See also* Memorandum Opinion and Order, Mimeo 1587, rel. Jan. 20, 1987.

35/ *Id*. at ¶ 38.

36/ Audit Report on Pacific Telesis, Inc., as submitted to the NARUC Staff Subcommittee on Accounts, July 11, 1986, at 13-6 ["PacTel Audit Report"].

37/ *Id*. at 2-3.

38/ *MIS* [Management Information Systems] *Week*, February 16, 1987, pp. 25, 27.

39/ Audit Report on BellSouth Corporation, as submitted to the NARUC Staff Subcommittee on Accounts, July 11, 1986, at 88, 89-90.

40/ Summary Report of the Regional Holding Company Investigations, submitted to the NARUC Subcommittee on Accounts (September 1986) at 21-22.

41/ 552 F. Supp. at 188, 224.

42/ *See* DOJ Report at 76, 97-98.

43/ As this Court has noted: "There is no formula for allocating common costs among services, and, even if there were, the fact is that the Regional Holding Companies alone possess all the relevant cost information and have a great deal of discretion in the treatment of such costs." 592 F. Supp. 846, 855.

44/ *Report and Order* in CC Docket No. 86-111, FCC 86-564, rel. Feb. 6, 1987.

45/ Instead, DOJ relied on an FCC news release summarizing its new cost allocation standards. *See* DOJ Report at 31-34 and n.69.

46/ 61 FCC 2d 587 (1976), *recon*. 64 FCC 2d 971 (1977), *further recon*. 67 FCC 2d 1441 (1978).

47/ *Joint Cost Order*, FCC 86-564 at ¶ 11.

48/ *See generally Joint Cost NPRM*, 104 FCC 2d 59, 65-67 (1986).

49/ *Joint Cost* Order at ¶ 235.

50/ Statement of Chairman Fowler before the House Appropriations Subcommittee on the Departments of Commerce, Justice and State, the Judiciary and Related Agencies, Feb. 25, 1987.

51/ DOJ Report at 66-67.

52/ *See MFJ*, 552 F. Supp. at 189.

53/ Huber Report at 3.2, 3.5.

54/ *See* FCC Industry Analysis Division, "Summary of Long Distance Carriers," Mimeo 1565 (Jan. 13, 1987).

55/ The losses for 1986 recently announced by two of the larger national carriers, U.S. Sprint and MCI, reflect their massive investments in new nationwide facilities in order to position themselves to compete with AT&T, as well as the advantages that AT&T's residual market power give it.

56/ Based on reports filed with the SEC through third quarter 1986, projected by Value Line through year-end 1986. *See also Wall Street Journal*, Jan. 22, 1987 at p.20; Jan. 23, 1987 at p.10; Jan. 27, 1987 at p.21; Jan. 28, 1987 at p.18; Jan. 30, 1987 at p.10.

57/ DOJ Report at 35; Huber Report at 3.16 & Table IX.8, Apps. B, F.

58/ In the Matter of a Consolidated Proceeding to Investigate the Provision of Intrastate Intercity Telecommunications Services Within the State of Minnesota, Minn. PUC Dkt. No. P-442/NA-84-212 (Oct. 15, 1985).

59/ An outside economist for Northwestern Bell (NWB) testified before the Minnesota PUC on November 12, 1986 that NWB retained as much as 98 percent of intraLATA toll business. He allowed that NWB's share could fall to as low as 93 percent at some unspecified time. Testimony of Dr. Frank Alessio, In the Matter of a Summary Investigation Into IntraLATA Toll Access Compensation for Local Exchange Carriers Providing Telephone Service Within the State of Minnesota, Minn. PUC Dkt. No. P-999/CI-85-582.

60/ For instance, Title II of the Communications Act envisions *first* the filing of a tariff, then Commission consideration, followed, if appropriate, by a hearing and a prescription of a modified tariff. 47 U.S.C. §§ 204, 205. In practice, the FCC often does not prescribe new tariff provisions, inasmuch as it is simpler under the Act for the Commission to reject a tariff and allow the carrier to file revised tariff provisions.

61/ Pole Attachments Act of 1978, *codified at* 47 U.S.C. § 224.

62/ NTIA Report at 50, *citing* Second Computer Inquiry, 77 FCC 2d 384, 426 (1980).

63/ DOJ Report at 100.

64/ 552 F. Supp. at 187 n.229. *See also* 592 F. Supp. at 853-54.

65/ Brief of United States in Response to the Court's Memorandum of May 25, 1982, filed June 14, 1982, at 30. *See also* Response of United States to Public Comments on Proposed Modification of Final Judgment, filed May 20, 1982, at 57 ("Neither of these problems [BOC discrimination and cross-subsidization] has thus far proven amenable to successful regulatory solution").

66/ *See* DOJ Report at 98 n.204; *see generally id*. at 26-34.

67/ *See, e.g., Communications Week*, Mar. 9, 1987 at p. 41 (An official of Communications Trends, Inc., a market research firm, stated: "There are abundant signs of a coming shakeout," in the Yellow Pages industry. The "lack of success for some of the competitive books will cause a retrenchment that is already under way").

68/ *Communications Week*, Mar. 2, 1987 at p. C-4.

69/ *Data Communications*, "Ma Bell and Her Seven Sisters," Mid-October 1984 at 22.

70/ Trade publications regularly report personnel transfers between BOCs and Bellcore. *See, e.g.*, "At PacTel Subsidiaries, Executives Often Move From Company to Company, Searching for the Right Job," *Communications Week*, March 9, 1987, pp. 14-15. *See also Communications Daily*, March 12, 1987, p. 4 (transfer of employee from Bell Atlantic Network Services to Bell of Pennsylvania).

71/ Billing/Collection Services, 102 FCC 2d 1150 (1986).

72/ In addition, allowing BOCs to provide out-of-region interexchange services will result in myriad practical and interpretative problems. For example, what will happen when, as will frequently occur, a subscriber to a BOC interexchange service attempts to place a call from outside the BOC's region to a point within its region? Will the call simply be blocked, a result that would be unsatisfactory to the customer? Will the BOC be permitted to connect its in-region intraLATA network with its out-of-region networks by arrangement with other carriers? (*Cf*. Order dated June 28, 1985 (unpublished), in which the Court permitted Pacific Northwest Bell to furnish a private network to the state government of Oregon with switching to interexchange facilities). Will the call be handed off to another carrier? If so, who will choose the carrier, and under what terms and conditions? Obviously, any such arrangement for calls that terminate or originate within its region will give rise to opportunities for abuse or circumvention of the remaining in-region interexchange prohibition.

73/ United States v. Western Electric Co., 592 F. Supp. 846, 874-75 (D.D.C. 1984).

74/ United States v. Western Electric Co., 627 F. Supp. 1090, 1095-96 (D.D.C. 1986).

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
)
Plaintiff,)
)
v.) Civil Action No. 82-0192
)
WESTERN ELECTRIC COMPANY, INC.)
AND AMERICAN TELEPHONE AND)
TELEPHONE COMPANY,)
)
Defendants.)

REPLY OF US SPRINT COMMUNICATIONS COMPANY

US Sprint Communications Company ("US Sprint") hereby submits its Reply to comments filed March 13, 1987 on the "Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment" ("DOJ Report").

In its initial comments US Sprint opposed the recommendations of the Department of Justice ("DOJ" or "Department") to relax or eliminate the line-of-business restrictions on BOC provision of interLATA and information services. Specifically, DOJ recommended that the Court allow the BOCS to provide out-of-region interLATA service immediately and in-region service where legal restrictions on intraLATA resale and entry have been removed.

Several commentors propose even further weakening of the interexchange restrictions to allow the BOCs to provide, within their regions, private networks and other interLATA services geared to the needs of large volume telecommunications users. In this Reply, US Sprint responds to issues raised in the comments of parties supporting or seeking to go beyond the DOJ recommendations.

There is no basis for any modification to the interexchange services restriction at this time. The market power conditions that resulted in adoption of the restriction remain unchanged in all relevant respects and, in fact, the BOCs are abusing their monopoly status even under the Decree's existing proscriptions.

The prohibition on BOC provision of interexchange services was intended to nullify incentives and opportunities for anticompetitive behavior that would arise if the BOCs became competitors in that market. Thus, if permitted to offer even the limited out-of-region service proposed by DOJ, the BOCs would become interexchange competitors with the inevitable incentives and opportunities for discrimination and cross-subsidy.

In view of this fact, BOC arguments for expansion of the recommendation to include certain in-region interLATA "submarkets" in which they allege that they lack market power also should be rejected summarily. Moreover, the in-region "markets" that the BOCs wish to serve are actually nothing more than packages of existing services targeted to large users. The small group of high volume interLATA customers which the BOCs seek to serve account for a disproportionately large share of interexchange carrier revenues.[1] Hence, permitting the BOCs to compete for this private network and other large user business would be tantamount to lifting the interLATA restriction in its entirety.

I. THE COMMENTS HAVE NOT MET THE SECTION VIII(C) STANDARD IN SEEKING REPEAL OF THE INTERLATA PROHIBITION FOR OUT-OF-REGION SERVICES

A. The Marketplace Conditions that Mandated the Imposition of the Restriction Remain Unchanged

It is clear that the interLATA line-of-business restriction was adopted to prevent the BOCs from using their monopoly power over local exchange facilities and services to discriminate against competitors in the interexchange market. In adopting the restriction, the Court noted that "[a]fter divestiture, the incentive of those who control the local networks to engage in such activity will remain unchanged: they would stand to gain business if other carriers were disadvantaged by poor access arrangements and high tariffs."[2] Events in the three years since divestiture have neither altered the continuing relevance of this rationale nor neutralized the anticompetitive incentives of the BOCs.

Arguments offered to the contrary by the BOCs and other commenting parties are unpersuasive, and certainly do not meet the Section VIII(C) standard.

The methods by which the BOCs may exploit their market power to harm competition in interexchange services have been well documented before this Court.[3] Through its monopoly control over local bottleneck facilities, a BOC would have the ability to favor its own interLATA carrier over competitors. Such preferential treatment could consist of "slow-downs in the interconnection of competitors' networks to the local switches; the grant of higher quality access to the monopoly provider's own competitive services; abusive regulatory and legal tactics; the manipulation of price for access; and the design of the local networks in such a manner as to discourage competition . . . ."[4]

The BOCs also remain fully capable of harming competition by cross-subsidizing their competitive ventures with income from their monopoly telephone service. Anticompetitive cross-subsidization presents a real danger for interexchange competition because there are many common costs with local exchange service which could be misallocated. For example, the Huber Report indicates that about 30 percent of an interexchange carrier's costs "require personnel and facilities identical to those used to perform similar functions for LEC operations."[5] Moreover, the cost shifting need not be massive to be harmful. Dr. Huber found that "[i]f the competing carriers pay a net subsidy of 30 percent of their revenue to local exchange operations, while a LEC manages to pay only 25 percent through its shared-use of non-tariffed facilities and personnel, the competitive advantage could be substantial, and the profits generated by the LEC's unregulated interexchange operations correspondingly large."[6]

As demonstrated in US Sprint's March 13, 1987 filing, the potential for anticompetitive abuse is not merely hypothetical, as several BOCs suggest in their comments, but rather presents a concrete danger to competition in the financially tenuous interexchange services market. Based only on their perception that they will soon be granted entry into the interLATA market, the BOCs already have begun to behave as interexchange competitors by seeking to leverage their market power. For example:

- This Court has already found that one BOC, US West, was engaging in discriminatory pricing of access facilities in bidding for a government contract.[7]
- Very recently, the ability of US Sprint to compete has been harmed by delays of several BOCs in granting equal access to BOC credit card databases in order to verify the validity of long-distance credit card charges.
- Southwestern Bell is attempting to obtain proprietary customer information in pursuit of its claim that, since all 800 Service traffic is "1+" traffic, it has the exclusive right to carry all 800 Service intraLATA traffic.

These incidents demonstrate that, even with the Decree restrictions and equal access in place, the BOCs are engaging in anticompetitive conduct harmful to interexchange carriers.

In short, the interexchange restriction was adopted in recognition of the fact that, following divestiture, the BOCs would have virtually the same exploitative abilities over interLATA competitors as they possessed in the unified Bell System. As US Sprint and others demonstrated in their comments on the DOJ Report, nothing has changed in competitive conditions or telecommunications technology in the last three years to alter the unequivocally correct assessment of the dangers of anticompetitive abuse that forms the basis of the Decree. The dangers to competition are not based merely on abstract economic theory, but on ongoing realities of the telecommunications marketplace.

The comments filed in support of the DOJ position have added nothing new on this point. Evidence adduced at trial in the AT&T action demonstrated that the Bell System abused its bottleneck control and, as the examples listed above show, the BOCs are continuing to pursue the same anticompetitive course. The BOCs have not carried their burden of proof in contending changed circumstances justify removal of interLATA restraints at this time.

B. Limitation Of BOC InterLATA Services to Out-Of-Region Offerings Has Not Been Shown to Eliminate Incentives and Opportunities for Anticompetitive Behavior

The Department of Justice recommends that the BOCs be permitted to provide interLATA services that both originate and terminate out-of-region on the grounds that the BOCs will be unable to discriminate in providing access since they do not control bottleneck facilities outside their local telephone areas. Moreover, DOJ claims that the risks of cross-subsidization are minimal in such a setting. Many parties filing comments on March 13 supported this recommendation. Those efforts, however, have not succeeded in remedying the DOJ's failure to meet the Section VIII(C) standard.

As shown by US Sprint's Comments of March 13, as well as by many other filings, the DOJ Report reflects an overly facile approach to the problem of BOC control over essential local facilities. In fact, limiting the BOCs to the provision of out-of-region interLATA service will not neutralize their incentives or opportunities to engage in discriminatory behavior. Even though limited to providing service out-of-region, the BOCs will still be competing with nationwide interexchange carriers, such as US Sprint, for many of the same customers. This will create incentives for the BOCs to discriminate against nationwide carriers in their own territories in efforts to lower their competitors' overall service quality and thereby gain a competitive advantage. The March 13 Comments in support of DOJ's out-of-region position have not added to the persuasiveness of the Departments'contentions.

Moreover, numerous opportunities remain for cross-subsidization through the misallocation of common costs. As indicated above, nearly 30 percent of the costs of an interexchange carrier's operation are the types of administrative overhead expenses which are subject to misallocation whether the interLATA service is in-region or out-of-region. Limiting the BOCs to out-of-region service would not assuage all concerns about cross-subsidization. Again, the comments of the BOCs and others to the contrary have failed to rectify the flaws in the DOJ argument.

Possibly the greatest immediate danger created by any BOC offering of out-of-region interexchange service is the BOCs' resulting self-perception as unrestricted long distance carriers, with accompanying incentives and motivations. If the BOCs view themselves as competitors, their incentives to discriminate against current and future service providers will be multiplied, possibly leading to premature network construction financed by ratepayer funds. The examples given above illustrate some of the effects of such a self-perception which have already occurred.

Moreover, the incremental market entry represented by out-of-region service will make it increasingly difficult for state and federal regulatory authorities to distinguish between authorized and unauthorized services. The efficacy of regulation in preventing abuses will suffer as a consequence.

Finally, the potential for competitive harm from BOC provision of out-of-region service is enhanced greatly by the nascent state of the marketplace. As the Department noted in its Report, the survival of competition at this time is unclear and AT&T's competitors are especially vulnerable to any anticompetitive conduct.[8] The Comments in support of DOJ have not bolstered the Department's inadequate attempt to refute these facts.

II. THE COURT ALSO SHOULD REJECT BOC PROPOSALS FOR EXPANSION OF THE DOJ RECOMMENDATION TO INCLUDE CERTAIN IN-REGION INTERLATA "SUBMARKETS"

Recognizing the danger of granting the BOCs wholesale entry into the interexchange market, the Department recommends that in-region services be prohibited until certain legal restrictions on intraLATA entry or resale are removed. To this end, DOJ proposed a variety of criteria for determining whether these regulatory barriers to entry have been eliminated. As the BOC comments correctly note, meeting reversal of longstanding social policies, often embodied in state statutes",[9] which will not be modified for some time.

Faced with this delay in their provision of in-region service even under the DOJ proposal, several of the BOCs have argued for expansion of the Department's recommendation to include a variety of in-region interLATA services geared to large volume telecommunications users. These services include private networks, terminating service, 800 Service, and consulting.

By all accounts, a small group of large users generate the great majority of all interLATA revenues.[10] Hence, the BOC proposals to serve large interLATA user needs in-region is not "limited" entry; for all practical purposes, it represents virtually unrestrained entry into the entire interLATA market. Given the importance to competition of this customer group, substantial incentives will be created for the BOCs to leverage their market power. Thus, all of the problems caused by BOC entry into out-of-region services will arise with even greater intensity if the BOCs' in-region proposals are adopted.

The BOCs justify this proposal by attempting to create certain "submarkets" in which they claim to have no ability to impede competition. These so-called "submarkets" all consist of offerings that are used primarily by a small group of large users that account for a disproportionately large share of total interexchange carrier revenues. Such market divisions cannot be validly drawn.

The record is clear that whether considering private networks, OUTWATS, 800 Service, or some other interLATA offering, there is not a separate "market" or "submarket," especially when considering the local facilities required. In each case, carriers utilize either "switched access" or "special access," with even theoretical competition applying only to the special access category. To a large extent, however, the BOCs' monopoly switched access service competes primarily with the BOCs' special access service because the choice between the two depends solely upon relative pricing. For example, Huber reports that:

> The per-minute price of switched access should be under half of what it now is, and if the FCC succeeds in its efforts to raise the subscriber line charge from $2 to $6 it will be. That change alone would shift a lot of traffic off lower capacity special-access lines and back on to the switched network.[11]

In view of this interchangeability of local services as they apply to the various "submarkets" identified by the BOCs, the BOCs can bring dramatic shifts in the attractiveness of local alternatives with new pricing schemes on either their switched or special access services. If permitted to make these discrete interLATA offerings, incentives will be created to influence pricing of the access services in order to assist the BOCs in the provision of the particular new offerings. This circumstance clearly is inconsistent with the BOCs' contentions that submarkets exist or that they lack market power in these discrete offerings. Moreover, given that much of the competition in the bypass market is a function of the BOCs' own pricing, it is inappropriate for them to claim that such "competition" operates as an effective limitation on their ability to abuse their market power.

In short, the BOCs have failed to establish that discrete submarkets exist wherein they lack market power. As a consequence, they have not met the Section VIII(C) requirements for any of the particular offerings. However, beyond the reasons already offered by US Sprint for retaining the general bar on BOC interLATA services, specific points regarding the new discrete in-region proposals are discussed below.

A. Private Networks

The most avidly sought after of the discrete in-region offerings is the so-called "private network" market. As described by Huber:

> A private network consists of transmission facilities, nodal switches, and other customer premises equipment configured for the exclusive use of a single geographically dispersed organization. The transmission facilities used in the network may, however, be provided largely or entirely by public (i.e. common) carriers, both local and interexchange.[12]

The BOCs argue that they have no power to impede competition in this particular offering under Section VIII(C).[13] For example, BellSouth argues:

> Section VIII(C) concerns regarding discrimination and cross-subsidy are satisfied through two technological developments: (a) most private networks avoid BOC switching entirely; and (b) for many high volume users, alternative technology to BOC special access allows a customer a reasonable economic alternative to BOC access facilities.[14]

The first of these claims is misleading; the second incorrect. First, the shift in many traditional switching functions from the central office to the user-owned PBX has not dissipated the bottleneck power of the BOCs. Contrary to the implication of BellSouth's arguments, it is not the many functions of the BOC central office switch that create a bottleneck -- it is the essential transmission medium of the local loop.

Almost all PBX's ultimately are connected to the local exchange network and make substantial use of it for off-network calling. As noted by Huber, "[w]hile there is an enormous range, even the largest customers rely extensively on LEC services and facilities . . . . All have many more switched access lines than they do dedicated-access lines, and all make a substantial fraction of their calls to off-network locations."[15]

Second, the claim that the availability of alternative bypass technology lessens BOC market power in the provision of non-switched access to large users is deceptive. Both Huber and DOJ emphasize that the incidence of bypass is minimal.[16] Quoting Huber, DOJ stated that "only about 0.1 percent of all interexchange traffic volume, generated by about 0.0001 percent of customers, moves directly from a non-LEC facility to an interexchange carrier. It appears that '[a]s of June 1986, only six customers actually were delivering point-to-universe traffic to AT&T via customer-provided (i.e., non-LEC) access facilities.'"[17]

This level of bypass, or even a much increased degree of activity, would not lesen the BOCs' anticompetitive opportunities. As Dr. Huber pointed out:

> Users' requirements for a bundle of local and interexchange services can make any discrete focus on alternative high capacity systems misleading. Control over a single, essential piece of a network, even a seemingly small and comparatively inexpensive one, may give a LEC strong leverage over the larger market. At a minimum it may give LECs "account control," that is a guaranteed foot in the door with large customers, a window on their business, and the power to insist on dealing directly with them.[18]

Finally, the BOCs argue that the large customers who utilize private networks will be able to detect and report practices which they find to be harmful or abusive. From an antitrust perspective, however, this view looks through the wrong end of the telescope. The Decree's concern is harm to competition through anticompetitive activity, not protection for large users receiving the benefit of such abuses.

In short, the BOCs have not shown that they lack the ability or the incentive to act in an anticompetitive fashion in providing in-region interLATA private networks. Accordingly, they have not met the Section VIII(C) standard.

B. Terminating Service

Parties also requested that the interLATA restriction be modified to allow the BOCs to terminate interLATA calls within their regions. Under DOJ's proposed out-of-region exception, the BOCs would be limited to interLATA calls that both originate and terminate out-of-region. BellSouth argued that such a limitation would create "a major competitive disadvantage for the BOCs" while "the ability to discriminate on the terminating end is minimal at most . . . ."[19] The FCC also commented in favor of allowing the BOCs "terminating ubiquity" via resale of the switched services of an unaffiliated carrier on the grounds that it would enhance interLATA competition.[20]

As demonstrated in Section II above, substantial anticompetitive dangers arise whenever the BOCs are permitted to become competitors in the provision of interLATA services, or even when they imagine that they will be permitted future market entry. This is true even where the BOCs are proposed to be limited to providing only out-of-region service. Any action to extend their permissible operations to include in-region service of any kind will exacerbate this problem. Thus, the attempt to meet the Section VIII(C) standard fails here for the same reasons that it is inadequate for out-of-region service generally.

Moreover, if a BOC is providing terminating interLATA service to a company with offices in its region, the BOC will gain an additional opportunity to maintain customer contact and control. Thus, if the BOCs are permitted to provide terminating interLATA calls within their regions, they will have enhanced power to exercise account control over large users within their territories. The BOCs arguments for competitive reciprocity in this regard are difficult to comprehend.[21] Of course no other interLATA competitor is burdened by the restraints of the MFJ; by definition, the MFJ applies only to the Bell companies. Moreover, Section VIII(C) is the relevant standard for modification of the Decree and it does not consider competitive reciprocity to be a relevant criterion.

C. 800 Service

The account control problem is even more pronounced if the BOCs are permitted to offer 800-type services, as at least one BOC requests.[22] Bell Atlantic argues that it should "be permitted to provide 800 and OUTWATS services between LATAs when the interexchange carriers are free to provide comparable intraLATA service."[23]

Although 800 Service results in only terminating minutes within the region, the called party, not the calling party, purchases the service. Even BellSouth recognized that Decree concerns thus are relevant for 800-type services.[24] Moreover, the FCC, though supporting ubiquitous terminating authority for calling billed to the originating party, recommended that, "it may be appropriate to continue a ban or place some additional restrictions on BOC provision of [800 Services] for now."[25] In contrast to the situation with equal access the agency stated that "BOC provision of multi-carrier 800 Service is being developed but has not yet been implemented."[26]

If the BOCs are permitted to offer 800-type services, they will have the ability to harm competition through abuse of market power. Not only would they have direct account control, the BOCs would stand to gain competitive advantage by discriminatory treatment of competitors in providing 800 Service interconnection facilities. Clearly, the Section VIII(C) standard has not been met here.

D. Consulting

Several BOCs also seek to provide "consulting" or "vendor coordination" services for large telecommunications users. These services are said to "range from meeting customer premises equipment needs to designing, procuring and managing all aspects of a customer's end-to-end telecommunications needs."[27]

If permitted to provide this broad range of consulting services, two potentially serious anticompetitive dangers arise. First, the BOCs will gain even greater "account control" over large users, thus becoming more entrenched in the intraLATA market. In the long run, this could slow the development of local competition. Second, the BOCs would necessarily be discriminating among interexchange carriers in designing end-to-end networks for clients in a way that could compromise their equal access obligations. This Court rejected a request for waiver to provide similar services in conjunction with shared tenant services, stating:

> Even though a particular Regional Company might not be directly selecting a certain interexchange carrier, it would be a simple task so to perform the traffic analysis and so to arrange the marketing that the carrier favored by the Regional Company would in any event be marketing a telecommunications package that included interexchange services - a fact that would give the company a strong incentive so to manipulate the switching and the priorities that the interexchange carrier selected for the shared system would prevail over competing carriers.[28]

Were the BOCs permitted to offer consulting services in conjunction with their own interexchange business as requested, it would present open opportunities for the BOC to favor its own carrier and create incentives to harm competitors both in terms of service quality and cost. The BOCs failed to meet the requirements of Section VIII(C) in the shared tenant services case and they have not remedied the shortcomings in their position by their March 13 Comments.

III. REGULATION ALONE WILL NOT LIMIT THE MARKET POWER OF THE BOCS OR ELIMINATE THE POSSIBILITY OF ANTICOMPETITIVE ABUSES

It has repeatedly been urged upon this Court that regulatory safeguards are sufficient to prevent the BOCs from abusing their market power. In response, this Court has consistently held that, if regulation were adequate, there would have been no need for the AT&T lawsuit.[29] Moreover, the Court has stated that "[t]here is nothing to indicate that a key assumption underlying the decree - that state and federal regulations alone cannot eliminate the possibility of anticompetitive abuses by the Operating Companies - is no longer valid".[30] Clearly, the line-of-business restriction on interLATA services would not have been necessary if it was believed that regulation alone could suffice to prevent abuse of market power.

Nevertheless, several parties in this proceeding claim that the decree's interexchange restrictions should be lifted in reliance on regulatory procedures. For example, BellSouth argues that any Section VIII(C) concerns about BOC entry into the in-region market could be satisfied by requiring the BOCs to enter through separate subsidiaries. This argument is groundless, however, since the imposition of a separate subsidiary does not prevent a BOC from using its monopoly power to impede competition.[31] Rather, at best, requiring a BOC to conduct competitive operations through a separate corporate entity would make intracompany favoritism easier to detect.

Ameritech advances a similar claim that divestiture now allows easy detection of anticompetitive abuses through comparison of RBOC benchmarks.[32] Once again this contention does not address the concerns of Section VIII(C). The parties to the Consent Decree recognized that a number of regulatory benchmarks would be available for evaluation purposes following divestiture. Therefore, neither a separate subsidiary requirement nor a set of benchmarks would meet the Section VIII(C) standard. The point of the Decree, however, is to prevent anticompetitive abuses, not merely identify them.

CONCLUSION

For the foregoing reasons, the Court should reject proposals in comments filed March 13, 1987 to lift the interexchange restrictions in any respect.

Respectfully Submitted,

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April 27, 1987

CERTIFICATE OF SERVICE

I, Lydia S. Furnells, hereby certify that on this 27th day of April, 1987, caused copies of the foregoing "Reply of US Sprint Communications Company" to be deposited in United States mail, first-class postage prepaid, addressed to each of the parties to this proceeding or their counsel, as specified in the orders of the Court and notices of appearances.

Lydia S. Furnells

Lydia S. Furnells

ISSUE CHECKLIST FOR RESPONSES AND REPLIES CONCERNING THE LINE-OF-BUSINESS RESTRICTIONS

Name of Party or Intervenor: US Sprint Communications Company

Please indicate the broad areas that you have addressed in your attached filing by checking the appropriate blanks below and indicating the pages in which you address each subject.

X **Interexchange Services Restriction** 1 to 22

______ **Information Services Restriction** ______

______ **Equipment/Manufacturing Restriction** ______

______ **Nontelecommunications Businesses Restriction** ______

______ **AT&T's Motion to Modify the Waiver Screening Procedure** ______

______ **Other Issues** ______

ENDNOTES

[1] *See* Huber, The Geodesic Network, January 1987, ("Huber Report") at 3.42 n.143 ("AT&T's largest customers, for example, are estimated to account for as much as 40 percent of its annual long-distance revenues").

[2] United States v. Western Electric Co., 552 F. Supp. 131, 188 (D.D.C. 1982), *aff'd mem. sub nom.*, Maryland v. United States, 468 U.S. 1001 (1983).

[3] *See*, *e.g.*, United States v. Western Electric Co., 627 F. Supp. 1090, 1094 (D.D.C. 1986) *rev'd on other grounds*, 797 F.2d 1082 (D.C. Cir. 1986); United States v. Western Electric Co., 592 F. Supp. 846, 853-855 (D.D.C. 1984); 552 F. Supp. at 188.

[4] 627 F. Supp. at 1094 n.7.

[5] Huber Report at 3.48.

[6] Id. at n.154.

[7] United States v. Western Electric Co., No. 82-0192, slip op., (D.D.C. Nov. 26, 1986).

[8] DOJ Report at 66-67.

[9] *See*, *e.g.*, Comments of BellSouth at 33.

[10] Huber Report at 3.42.

[11] *Id*. at 3.43 n.145.

[12] Huber Report at 3.45.

[13] *See* Comments of BellSouth at 37; Comments of US West at 40-41; Comments of Ameritech at 46; Comments of Bell Atlantic at 11.

[14] Comments of BellSouth at 37.

[15] Huber Report at 3.46.

[16] *Id*. at 3.9, Table IX.5; DOJ Report at 80.

[17] DOJ Report at 80-81.

[18] Huber Report at 3.45.

[19] Comments of BellSouth at 45.

[20] Comments of the FCC at 33.

[21] *See* Comments of Bell Atlantic at 9. Bell Atlantic erroneously analyzes the DOJ in-region proposal on the basis of a "competitive reciprocity principle" rather than Section VIII(C).

[22] *Id*. at 16.

[23] *Id*.

[24] Comments of BellSouth at 45 n.22.

[25] FCC Comments at 32 n.35.

[26] *Id*.

[27] Comments of BellSouth at 39.

[28] 627 F. Supp. at 1100 n.39.

[29] See 627 F. Supp. at 1097 n.22; 592 F. Supp. at 869; 552 F. Supp. at 187 n.229.

[30] 592 F. Supp. at 869.

[31] The Department of Justice specifically recommended against judicial imposition of a separate subsidiary requirement for BOC provision of interLATA services. DOJ Report at 71 n.143.

[32] See also Comments of US West at 39.

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
Plaintiff,)
v.) Civil Action No. 82-0192
WESTERN ELECTRIC COMPANY, *et al*.,)
Defendants.)

RESPONSE OF COMPETITIVE TELECOMMUNICATIONS ASSOCIATION TO COMMENTS FILED ON THE REPORT AND RECOMMENDATIONS OF THE DEPARTMENT OF JUSTICE

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April 27, 1987

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,
Plaintiff,
v.
WESTERN ELECTRIC COMPANY, et al.,
Defendants.

Civil Action No. 82-0192

RESPONSE OF COMPETITIVE TELECOMMUNICATIONS ASSOCIATION TO COMMENTS FILED ON THE REPORT AND RECOMMENDATIONS OF THE DEPARTMENT OF JUSTICE

The Competitive Telecommunications Association ("COMPTEL"), by its attorneys and pursuant to the Court's Memorandum and Order of February 4, 1987, hereby submits this Response to Comments filed March 13, 1987 ("March 13 Comments") on the Report filed by the United States Department of Justice on February 2, 1987. COMPTEL, the principal industry association of competitive interexchange carriers, filed its own Comments on the Department's Report on March 13, 1987, directed toward the Department's recommendation that the MFJ interexchange services prohibition be substantially revised.

In their March 13 Comments on the DOJ Report, the BOCs and their supporters, including the Federal Communications Commission, contend that DOJ's recommendation to permit out-of-region and limited in-region BOC interexchange services is insufficient. The BOCs want immediate permission to offer intra-region interexchange services, at least in certain allegedly "distinct" interexchange service submarkets and/or for the termination of calls originating from outside their regions. The BOCs insist that regulatory oversight will be more than adequate to ensure that they cannot engage in anticompetitive behavior toward competing interexchange carriers. In this Response, COMPTEL will contest each of these assertions.

I. IN-REGION INTEREXCHANGE SERVICES CANNOT BE DIVIDED INTO SUBMARKETS FOR REGULATORY PURPOSES

Implicitly conceding that their market power in local exchange services continues to justify competitive protections for in-region interexchange services generally, several BOCs argue that they at least should be permitted to provide particular types of interexchange services. NYNEX, for example, concedes that "the market for message telecommunications service to small users . . . is wholly dependent on local exchange access," but contends that there are other submarkets that "are largely independent of local exchange access." NYNEX's two examples are the "international dedicated services market" and the "large business customer market."[1] Other BOCs list such purportedly "distinct" service markets as all "private networks," interLATA packet network services, and 800 and OUTWATS services.[2] In essence, the BOCs contend that because these "markets" are distinct and independent of the local exchange bottleneck, BOC entry would carry no potential for anticompetitive effects.

In order for the BOCs' "market segmentation" approach to succeed, two elements must be proven: (1) it must be established that each "segment" constitutes a distinct, definable market or submarket for purposes of antitrust analysis, without close substitutes available from other services; and (2) the services involved must be independent of and immune from the anticompetitive opportunities arising from the BOCs' local exchange bottlenecks. The market segmentation approach manifestly fails on both counts. As shown below, BOC claims that their proffered "market segments" are easily definable and separable are conclusory, unworkable and indeed refuted by BOCs themselves in other ongoing proceedings. Moreover, the DOJ Report recognized that BOC entry into such ill-defined service "submarkets" would be accompanied by substantial risk of anticompetitive abuses.

A. No Distinct Submarkets Exist

The BOCs cite no evidence of their own to support the proposition that various service submarkets are neatly severable from interexchange services generally,[3/] but rely instead on conclusory statements and/or generalizations in the Huber Report. However, although the Huber Report discusses a "private network" market segment, even Dr. Huber questions whether it is "sensible to draw a market and regulatory distinction between switched and unswitched telecommunications services."[4/] The DOJ Report has found that "private networks" too rely heavily on local exchange facilities and services.[5/] Moreover, the FCC determined in 1983 after a lengthy inquiry that interexchange communications is a single relevant product market with no distinct submarkets. Finally, in the context of an ongoing FCC proceeding, the National Telecommunications and Information Administration ("NTIA") and the BOCs themselves agree that telecommunications services cannot be separated into distinct submarkets.

1. The FCC Has Explicitly Found That Interexchange Services Constitute a Single Product Market

Less than three and a half years ago, the FCC expressly determined that "all interstate, domestic, interexchange telecommunications services comprise a single relevant product market with no relevant submarkets."[6/] Because "customers switch among types of services and suppliers in response to their relative mixes of quality and price,"[7/] the FCC concluded that "within very broad limits, telecommunications transmission media -- wire pairs, coaxial cable, terrestrial microwave, fiber optics, or satellite transponders and earth stations -- can be adjusted readily to provide virtually any service efficiently."[8/]

The FCC's conclusion remains correct today. Although telecommunications is a dynamic industry, it is not so dynamic that this carefully considered finding by the principal regulatory agency could be vitiated in less than 3½ years. Whether considering in-region or out-of-region interexchange service, submarkets cannot be identified discretely because the categories merge into an amorphous blend of arbitrary distinctions. From the perspective of both consumers and suppliers of services, discrete telecommunications subunits cannot be identified for regulatory purposes. The FCC concluded five years ago, for example, that "WATS and MTS have been found to be like services. They have similar costs within the PSN [public switched network], and exhibit virtually identical calling patterns in terms of distance."[9]

While the FCC is now proposing to depart from its finding in the Fourth Report and to adopt a service-by-service approach to regulation of certain basic telecommunications services[10] -- an approach which has been roundly criticized as impracticable by the vast majority of commenters on its proposal[11] -- even the Commission "recognize[s] that as technology changes and new supply and demand substitutes appear, the definitions of any submarkets that we determine are likely to change, in many cases in significant ways."[12] Indeed, to an ever-greater extent telecommunications facilities are used interchangeably to provide a host of interexchange and access services.[13]

NYNEX does not even suggest where the dividing line between the "large business customer market" and all others should be drawn, nor has any regulatory body made such a suggestion. Moreover, while "private networks," for example, could be viewed as distinct from "public" network services in the extreme and rare case where the BOC furnishes facilities to a large user for purely intra-company communications, in almost every instance customers large and small utilize BOC transmission lines interchangeably for a panoply of services. In the future, with the development of Integrated Services Digital Networks (ISDN) and the progressive installation of digital switches and transmission facilities into interexchange networks, customers will have even more ability to purchase bandwidth and switching functions on a variable real-time basis to satisfy their requirements without regard to service classifications.[14]

2. BOC Representations in a Pending FCC Proceeding Directly Contradict Their Positions Herein on "Market Segmentation"

As noted above, in a pending rulemaking proceeding the FCC is proposing to reduce regulation of certain basic telecommunications services provided by AT&T and the BOCs on a service-by-service basis.[15] Most commenters in that proceeding, including

NTIA, AT&T and several BOCs, have affirmed the infeasibility of attempting to identify narrow sub-markets within the telecommunications industry. NTIA concludes that the Commission's service-by-service analytical approach cannot work. Indeed, NTIA finds that such an approach is becoming increasingly infeasible with new technological developments:

> As a practical matter, the task of identifying submarkets is difficult, as technological advancements expand the range of service offerings that are interchangeable. The potential problem becomes even more difficult when the submarkets selected are especially narrow.[16/]

AT&T noted that users frequently shift among telecommunications services depending on their usage and the respective price of services. Customers can interchangeably use MTS, WATS and private line services to satisfy their requirements.[17/] On the supply side, AT&T perceives a similar pattern of substitutability "because telecommunications transmission facilities can be easily shifted from one service to another."[18/] In its Comments to the FCC, DOJ stated that it "does not believe that contract services constitute a separate market"[19/] because, among other things, BOC "access facilities may be used to serve a wide range of customers and to provide a wide range of services."[20/] DOJ also concluded that "packet switching may not constitute a separate relevant market as that term is used in economic analysis."[21/]

Most significantly, and in stark contrast to the positions stated in their March 13 Comments herein, several BOCs have asserted in this FCC proceeding that the Commission's proposed service-by-service approach to deregulation is not feasible. BellSouth, for instance, stated that the Commission's approach "is immensely complex and fraught with problems." It argued that a market segmentation regulatory framework would engage the Commission and parties in "inconclusive arguments about market and submarket definitions and market share."[22/] That BellSouth position is wholly at odds with its claim before this Court that "under current economic and technological conditions, certain submarkets of interLATA services are positioned so that intraregional Section VIII(C) relief is appropriate."[23/] BellSouth has made no effort to justify or explain, or even acknowledge, this contradiction in its positions to this Court.

Similarly, Southwestern Bell told the FCC that "[t]he submarket approach is potentially a very costly and extremely complex means of streamlining regulation."[24/] Yet in the instant proceeding, Southwestern claims that, for example, "private network services are clearly distinguishable from the public switched network services."[25/] Pacific Telesis does not comment on this issue in its March 13 Comments to this Court, but before the FCC it declared that "[t]elecommunications services do not fall into neat, separable submarkets with little substitutability across submarkets," and so asserted that the Commission's service-by-service "approach is doomed to failure."[26/]

These observations apply with equal force in the instant inquiry. The telecommunications market in the United States simply is not susceptible to clean separations into different market "segments" because the various elements are inextricably intertwined and frequently substitutable for one another. Absent a far more concrete and persuasive showing by the BOCs that "competitive" interexchange market segments can be distinguished and segregated from all other segments of the market, there is absolutely no basis for this form of dismemberment of the MFJ's interexchange prohibition.

3. The BOCs' Claims Are Unsupportable Under Traditional Market Definition Analysis

In addition, it is notable that no BOC has made the slightest effort to show that any proffered "market" or "submarket" is a relevant market or submarket for purposes of antitrust analysis,[27/] or that BOCs possess no market power in the purported markets or submarkets. A relevant product market or submarket is determined by the substitutability between the product and other products.[28/] Accordingly, any such market or submarket must be delineated so as to include close demand and supply substitutes for the product involved.[29/]

Having made no showing to satisfy these tests, the BOCs' market segmentation arguments constitute nothing more than empty words and cannot be seriously regarded by this Court. In any event, these arguments are groundless in the context of today's readily interchangeable telecommunications facilities and service configurations. As noted above, the FCC has found that "[i]ncreasingly, customers purchase bandwidth capacity, not a service for a specific type of transmission or a service provided by a specific transmission medium," and that transmission media are readily adoptable to provide virtually any service efficiently.[30/] Indeed, the courts have ruled that services provided via facilities as different as satellites and terrestrial communications systems are reasonably interchangeable for most customers.[31/]

In the AT&T divestiture litigation, the government correctly identified the "relevant market areas" as, inter alia, "local telecommunications service" and "intercity telecommunications service," without relevant submarkets.[32/] The divestiture settlement and the MFJ adopted those market boundaries.[33/] Mere assertions by the BOCs that separable markets or submarkets now exist, such that the Court must modify the MFJ's prohibition on BOC provision of "interexchange services" to include some types of services and exclude others, are unavailing.

B. All the "Markets" Identified by the BOCs Are Dependent on BOC Local Networks

As AT&T commented, no matter what the service "segment" -- small users or "large business users," conventional public network subscribers or "private networks" -- virtually all connections are made through the LEC local loop.[34/] As the DOJ and Huber Reports acknowledged, interexchange carriers continue to depend on these local facilities to carry 99.9 percent of all interexchange traffic and to reach 99.9999 percent of their customers.[35/] General Electric's Comments observe further that "private networks still have to interconnect with the LEC public network, and Huber does not clearly explain how this private networking outside the bottleneck has improved the situation with regard to local access, inside the bottleneck."[36/] Most significantly, the DOJ Report refused to recommend intraLATA relief for "private network users" on the ground that "even the largest private network customers rely on LEC services and facilities other than special access lines." As a result, "the local BOC is likely to retain significant bottleneck power with respect to interexchange services."[37/]

Thus, the services cited by the BOCs do not avoid their local exchange bottlenecks, and the BOCs' claims that these subsets of interexchange service are insulated from potential anticompetitive abuse of BOC market power are baseless.

C. The BOC Proposals Ignore DOJ's Finding That Anticompetitive Potential Is at Its Apex for Interexchange Services Within a BOC's Region

Finally, simply dividing the domestic interexchange telecommunications market and allowing the BOCs to offer service to segments thereof would remove neither the BOCs' ability nor their incentives to engage in anticompetitive practices against interexchange service providers. In particular, the BOCs' "market segmentation" arguments fail to explain how a BOC's provision of certain in-region interexchange services would be free of the significant continuing opportunities for discrimination, cross-subsidization and misallocation of costs described in detail in the DOJ Report.

Recent events reaffirm that the BOCs continue to leverage their bottlenecks to the fullest.[38/] The Department recommended that the BOCs not be permitted to provide in-region interexchange services generally, because "the BOCs' bottleneck power . . . confers on them significant opportunities for anticompetitive conduct" within their own regions,[39/] including discrimination in access pricing, access to customer information, technical quality of access and access to network information.[40/]

Among other things, the BOCs "clearly would have the incentive to favor their own interexchange services, and the complexities of correct access charge pricing rules may make such discrimination difficult to detect."[41/] Indeed, in the one area of interexchange service in which the BOCs participate now -- intraLATA toll service -- the BOCs favor their own services and put intraLATA interexchange competitors' offerings at a severe price disadvantage by refusing to impute to themselves the access charges that they assess to their competitors. Furthermore, DOJ correctly noted that the potential for BOC cost misallocation and cross-subsidization of competitive services from monopoly revenues is greatest when the competitive service is provided in whole or in part within the BOC's geographic region.[42/]

For all of the foregoing reasons, COMPTEL submits that the BOCs' arguments in favor of dismantling the interexchange restrictions with regard to various and sundry alleged market segments should be summarily rejected.

II. THE BOCs SHOULD NOT BE PERMITTED TO PROVIDE INTEREXCHANGE SERVICES THAT TERMINATE WITHIN THEIR REGIONS

BellSouth, Ameritech and the FCC contend additionally that BOCs should be permitted to provide what the FCC terms "terminating ubiquity" for interexchange services -- that is, they should be permitted to distribute incoming interLATA calls to end users everywhere, including within their regions.[43/] The FCC would require the BOCs to provide such terminating service within their own regions only "through the resale of an unaffiliated carrier's generally available switched service."[44/]

The Comments of COMPTEL and numerous other limited intervenors in this proceeding demonstrated that the continuing ability of the BOCs to wield their local bottleneck monopoly power against interexchange carriers requires retention of the nationwide interexchange prohibition at this time. Even wholly outside their regions, substantial opportunities exist for collusion and cooperative arrangements among BOCs, especially through information exchanges arising from their common participation in Bellcore.[45/] Improper cost allocations and cross-subsidization of out-of-region operations are also possible.[46/] Moreover, the BOCs have the ability and incentive to use their local bottlenecks to discriminate against interexchange carriers with whom they would be competing in other regions.[47/] If the BOCs were permitted to provide both out-of-region interexchange service and in-region termination, either themselves or through resale, their opportunities for anticompetitive activities would increase correspondingly.

The "terminating ubiquity" proposal suffers from other defects as well. For example, allowing BOCs to terminate long-distance calls within their regions would permit them to bundle local and interexchange service packages for business customers who have operations and telecommunications needs outside the BOC's region. This would confer upon BOCs a decided competitive advantage over other interexchange service providers. That is, the BOC could provide the business user with both the full panoply of local exchange and intraLATA services and interexchange services from anywhere outside its region to anywhere within its region. Such a service package -- lacking only interexchange services originating within the BOC's region -- could not be matched by a competitor who could offer only interexchange service but no local service. In short, a BOC could more completely fulfill what the Huber Report characterizes as "users' requirements for a bundle of local and interexchange services," and would arm the BOC interexchange service provider with an unmatchable menu of services with which to obtain the "foot in the door with large customers"[48/] that it already enjoys for local telecommunications services.

In arguing for termination ubiquity, Ameritech claims that "the local exchange carrier is unable to pick out and discriminate against particular calls in the large bundle of [interexchange] traffic delivered for termination."[49/] However, this would not be true under a "Line Information Data Base Technology" ("LIDB") service proposal developed by Ameritech itself.[50/] LIDB would furnish operator service on interLATA calls and would handle all "0" and "0+" interLATA calls for interexchange carriers which elect to receive such services.[51/] To provide such services, each BOC would create its own LIDB to verify, for example, that on a collect call the person who accepts the charges is not using a public telephone, or that on a call charged to a calling card the card number is valid and not reported stolen.[52/] Under this plan, the calling party's telephone number will be forwarded to the interexchange carrier which transports the call to the BOC local exchange at the terminating end.[53/] If that interexchange carrier is also the BOC in the region where the call terminates, provision of this information raises the distinct possibility of discrimination by the BOC, which will "know" at the terminating end local exchange interconnection which incoming calls are its own and which are from other interexchange carriers.

Thus, permitting the BOCs to provide interexchange services including termination of calls within their own regions, either directly or indirectly, would increase their ability and incentives to discriminate against interexchange carriers within their regions. Not even the Huber Report found a complete lack of possibilities for discrimination at the terminating end of calls, but only that they would be "much lower than at the originating end."[54/] At the very least, a BOC would have the ability and incentive to parlay its ability to discriminate against interexchange carriers within its region into favorable conditions for the switched services it purchases from the unaffiliated carrier to achieve termination of incoming interexchange calls. It could also disadvantage all interexchange carriers other than its unaffiliated carrier of choice. And, of course, even if the BOC is required to purchase switched services from an unaffiliated carrier, the "last mile" of every call will almost always be transmitted through the BOC local network. In sum, there is no adequate justification for relaxation of the MFJ's interexchange services prohibition to permit BOCs to provide long-distance service outside their regions, much less from outside their regions to terminating points within their regions.

III. BOC CLAIMS THAT REGULATORY OVERSIGHT IS ADEQUATE TO DETER ANTICOMPETITIVE PRACTICES IN INTEREXCHANGE SERVICES IN OR OUT OF THEIR REGIONS ARE UNAVAILING

The BOCs contend in lockstep that existing regulatory safeguards would ably protect the public from anticompetitive abuses if the interexchange prohibitions were eliminated or relaxed. Pacific Telesis, for example, baldly asserts that "assuming market power existed, today's effective regulation neutralizes any remaining [BOC] ability to exercise such power to sustain an unfair competitive advantage in other markets."[55/] According to PacTel, "today's effective regulation" is to be "seen in the FCC's current access charge decisions, in its decisions in the Computer II and Computer III matters and in its press for new accounting rules."[56/] Years of frustrating experience surrounding regulatory efforts to deter anticompetitive practices in the telephone industry, as well as the representations and deregulatory actions of the relevant regulatory agency, belie such contentions. Indeed, these and other FCC initiatives have weakened, not strengthened, the agency's ability to detect and prevent such anticompetitive practices.

A. The FCC's Comments Acknowledge That Its Current Regulatory Mechanisms Are Not Readily Adaptable to BOC Interexchange Service Offerings

In its March 13 amicus Comments, the FCC acknowledges that it presently has inadequate regulatory mechanisms in place to oversee BOC provision of interexchange services. The FCC admits that it "would have to address additional issues prior to BOC entry into interexchange markets barred by the MFJ."[57/] For example, the Commission effectively acknowledges that its recent Joint Cost Order is not directly applicable to BOC interexchange services, allowing that "while the Joint Cost Order provides rules for separating regulated and unregulated activities, analogous guidelines might be needed to address cost allocations for interLATA and interexchange activities."[58/] The FCC presents a list, "not intended to be exhaustive," of several areas for consideration that would require attention prior to any BOC entry into the interLATA services market, including: (1) modifications to the Competitive Carrier dominant/non-dominant classifications; (2) the proper degree of separation (structural or accounting); (3) rate of return treatment for BOC interexchange services; (4) access charge treatment when a BOC resells the services of an unaffiliated interexchange carrier; (5) disclosure rules for network and customer proprietary information; and (6) application of the requirement of equal access, and possibly Comparably Efficient Interconnection (CEI) and Open Network Architecture (ONA) requirements, to ensure fair competition when a BOC offers interLATA services.[59/]

Thus the FCC specifically recognizes that "BOC entry into interexchange markets currently proscribed by the decree raises many issues that this Commission must address independently prior to such BOC entry."[60] In the face of such affirmations by the Commission, the BOCs' arguments that adequate regulatory safeguards now exist to monitor anticompetitive behavior lack credibility.[61]

B. The FCC Lacks the Resources and May Lack the Desire to Develop and Enforce Effective Regulation to Deter BOC Anticompetitive Practices in the Interexchange Market

In 1982, DOJ pointedly declared that the inability of the FCC and state regulatory commissions to regulate effectively monopoly and competitive telephone services was the prime factor necessitating the MFJ:

> At the heart of the government's case in United States v. AT&T was the failure of regulation to safeguard competition in the face of the powerful incentives and abilities of a firm engaged in the provision of both regulated monopoly and competitive services. Neither of these problems [cross-subsidization and discrimination] has thus far proven amenable to successful regulatory solution. Indeed, the very basis for divestiture is that the anticompetitive problems inherent in the joint provision of regulated monopoly and competitive services are otherwise insoluble. Thus, permitting BOC entry into competitive markets would undermine the rationale for the divestiture that is the central remedial mechanism of the modification.[62]

Even assuming arguendo that the FCC somehow may now be more capable of developing effective regulatory controls to prevent BOC cross-subsidization and discriminatory practices in the interexchange marketplace notwithstanding the failures of more than two decades that necessitated the divestiture of AT&T, it is singularly unclear that the Commission could or would marshall its scarce resources to achieve this result. Indeed, as COMPTEL's March 13 Comments observed, the FCC is planning to reduce its investigative resources even as it acknowledges the "additional issues" raised by BOC entry into the interexchange market, proposing to decrease the Common Carrier Bureau's field auditing personnel and capability and to rely instead on independent audits commissioned by the BOCs.[63]

If the Commission is decreasing its workforce assigned to the monitoring of the BOCs, it is difficult to understand how it could effectively develop and enforce the regulatory safeguards necessary to monitor BOC behavior in the provision of interexchange services. In addition, the Commission clearly is steering in the direction of deregulation of BOC tariffs, separations and business activities, thus depriving itself of regulatory tools it may urgently need if it is adequately to monitor BOC activities.[64/] It is evident that the FCC has even less capability to guard against BOC abuses, in terms of both financial and staff resources and regulatory powers, than it did in 1982.

C. The "Benchmark" Approach to Regulatory Oversight Is Ineffectual

NYNEX and Ameritech make much of the contention that each BOC's actions and regulatory filings will provide a "benchmark" by which to compare the actions of others.[65/] Their arguments are not persuasive for several reasons.

In the first place, the FCC has not enjoyed past success with benchmark regulation.[66/] Moreover, in future attempts to compare different BOC cost allocation schemes under its new Joint Cost Order,[67/] the FCC will face significant obstacles. The Joint Cost plan involves complex determinations of a type that neither the BOCs nor the FCC has ever attempted before, and the FCC has issued only general guidelines for the content and methodology of the new cost allocations manuals to be developed individually by each of the BOCs. Indeed, each BOC will be developing its own specific rules for implementing the Commission's general guidelines. The Commission has acknowledged:

> It is not clear that carriers will be consistent in identifying costs as directly assignable. Because this determination can be influenced by subjective considerations, there is a possibility that carriers could manipulate the amount and type of costs that they identify as directly assignable in order to manipulate the allocator [employed for common marketing costs].[68/]

As the ETI Report observes, "the system does not appear to be designed for benchmark-type regulation."[69/]

Attempts to compare BOC access tariffs provide a good example of the deficiencies of "benchmark" comparisons.[70/] The BOCs' annual 1987 access tariffs filed with the FCC on October 3, 1986, for example, contained extraordinarily large, unexplained variations and inconsistencies among BOCs for numerous categories of charges.[71] Despite these manifest inconsistencies, the charges ultimately were allowed by the FCC. Even when the FCC attempted to require the BOCs to undertake uniform, statistical samples of the actual units of demand in order to better oversee access pricing, the Office of Management and Budget rejected this regulatory effort under the Federal Paperwork Reduction Act.[72] Although the FCC may resubmit its proposal, this experience illustrates the formidable barriers to accumulating comparable data in order to "benchmark" the BOCs.

D. The GTE Consent Decree Is Inapposite to This Triennial Review of the MFJ

Several BOCs, including BellSouth, Southwestern Bell, and U S West, argue that the Court should permit them to provide interexchange services as it permitted GTE to become an interexchange provider in approving GTE's acquisition of Southern Pacific Communications' "Sprint" interexchange service in 1984.[73] When the Court allowed GTE to acquire Sprint subject to creation of a separate subsidiary and other provisions, however, it expressly distinguished the BOC situation from that of GTE.

The Court found that GTE's operations are "widely scattered," in contrast to the BOCs' region-wide dominance of local telecommunications, thus lessening significantly the likelihood of monopolistic behavior. Furthermore, the Court noted that the BOCs "have the facilities to provide all the intercity and interLATA traffic throughout their regions, while the GTE operating companies control little by way of intercity facilities."[74] Moreover, "in terms of concentration, the GTE companies serve roughly half as many telephones per square mile as do the [BOCs]."[75]

BellSouth comments that "Dr. Huber recognized that because GTE's local exchange operations are geographically dispersed, that dispersion may be an advantage in maintaining, servicing and marketing its affiliated national network."[76] Yet this Court has already found that such geographic dispersion would attenuate whatever discrimination advantages Sprint might gain.[77] U S West, on the other hand, claims that because its local exchange operations are more predominantly rural than GTE's, U S West has even less monopoly power. This contention is equally unpersuasive because, as the Court found, GTE lacks the pervasive regional domination of the BOCs in the areas they serve.[78]

In sum, in 1984 the Court considered and rejected BOC arguments that the GTE decree precedent applied to the limitations on BOC activities contained in the MFJ. In the absence of documentation of materially changed factual circumstances by the BOCs, their attempt to relitigate that issue should be summarily rejected.

IV. THE BOCs HAVE SHOWN NO POST-DIVESTITURE TECHNOLOGICAL OR MARKET DEVELOPMENTS THAT JUSTIFY ANY RELAXATION IN THE BOC INTEREXCHANGE RESTRICTIONS AT THIS TIME

Each of the BOCs also contends that technological and market developments since the entry of the MFJ have vitiated the need for the interexchange prohibition. Again, the BOCs present no evidence of their own to support these contentions, preferring instead to rely, as the DOJ Report did, on the conclusions of the Huber Report.

For example, U S West alludes to the allegedly "dramatic developments in the intervening years that are shown by the Huber Report."[79] Other Comments, however, demonstrate numerous flaws in Dr. Huber's premises and conclusions. Indeed, AT&T points out that Dr. Huber's "geodesic dome" model "rests on a misunderstanding of principles of engineering and network design that are so basic they were stipulated to in United States v. AT&T."[80] Networks are not established because switching is expensive relative to transmission. In fact, the opposite is true. Networks are created because their switching capability can be used to reduce transmission costs. Advances in technology have made economical the creation of switches with greater capacity, hence fewer switches are needed. As a result the number of interconnections has increased not decreased.[81] Moreover, the much-ballyhooed proliferation of PBXs has not diminished BOC local bottlenecks, inasmuch as PBXs rarely connect directly to one another through facilities bypass. Rather, "all traffic to and from these subscribers and to and from interexchange carrier networks, still passes over and through the BOCs' local loops and local switches."[82]

The BOCs themselves clearly do not regard facilities bypass as a competitive threat to their local exchange monopolies. For example, Bell Atlantic's 1987 Annual Access Tariff filing to the FCC evaluated bypass for the 1987 period and, concluding that "its effect on total company demand is small," assumed that no facilities bypass would occur in 1987.[83] Other BOCs view bypass as a business opportunity that they, not interexchange carriers, will capture. As the Chairman of NYNEX noted recently: "There is no way, for instance, that AT&T can provide those bypass-type services more cheaply than we can. We are very competitive in the local loop arena."[84]

Finally, while several BOCs claim that "equal access is a reality"[85] and that the interexchange prohibition should be lifted on this basis, COMPTEL's Comments documented that equal access remains unavailable to interexchange competitors in substantial areas within BOC territories and that the BOCs have refused to provide even nominal equal access for intraLATA interexchange service.[86] As an example, while NYNEX actually boasts that equal access will be available to all lines "in our two key market areas by the end of 1989" and that it is "committed" to provide full equal access to all of its offices by the end of 1992,[87] these dates are more than 2½ and 5½ years distant, respectively -- perhaps of probative value during the third triennial review of the MFJ, but surely not the first. As the Huber Report revealed, NYNEX to date has converted only 56 percent of its lines to equal access.[88] Provision of equal access for competitive interexchange carriers by the BOCs, then, remains an uncompleted task.

In sum, no technological or market developments since divestiture justify BOC entry at this time into the interexchange services marketplace, in whole or in part, under Section VIII(C)'s "no substantial possibility" standard. As this Court recognized only fifteen months ago:

> The only distinction between the "old" Bell System and the present Regional Company system was and is that the Bell monopoly was nationwide in scope while each of the seven Regional Companies possesses and equally powerful monopoly in a particular geographic region. . . . [T]he ability to exploit the bottlenecks anticompetitively has remained precisely the same.

United States v. Western Electric Co., 627 F. Supp. 1090, 1095 (D.D.C. 1986).

V. CONCLUSION

In light of the foregoing, COMPTEL submits that the BOCs' Comments on the DOJ Report and Recommendations fall far short of the required "showing by the petitioning BOC that there is no substantial possibility that it could use its monopoly power to impede competition in the [interexchange] market," MFJ § VIII(C), 552 F. Supp. at 231, with respect to either in-region or out-of-region interexchange services. Accordingly, the DOJ Report's recommendations with respect to BOC provision of interexchange services should be rejected.

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I, Donald M. Itzkoff, hereby certify that copies of the foregoing Response of the Competitive Telecommunications Association to Comments Filed on the Report and Recommendations of the Department of Justice have been served via first class mail, postage prepaid on this 27th day of April, 1987 to the parties indicated on the attached service list.

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ISSUE CHECKLIST FOR RESPONSES AND REPLIES CONCERNING THE LINE-OF-BUSINESS RESTRICTIONS

Name of Party or Intervenor: COMPETITIVE TELECOMMUNICATIONS ASSOCIATION

Please indicate the broad areas that you have addressed in your attached filing by checking the appropriate blanks below and indicating the pages in which you address each subject.

X	Interexchange Services Restriction	all
	Information Services Restriction	
	Equipment/Manufacturing Restriction	
	Nontelecommunications Businesses Restriction	
	AT&T's Motion to Modify the Waiver Screening Procedure	
	Other Issues	

ENDNOTES

1/ NYNEX Comments at 11-12.

2/ See, e.g., Bell Atlantic Comments at 10-16; Ameritech Comments at 45, 62; BellSouth Comments at 34; Southwestern Bell Comments at 28; U S West Comments at 13-14.

3/ See, e.g., NYNEX Comments at 37; Ameritech Comments at 48, citing Huber Report at 3.39-3.40.

4/ Huber Report at 3.38.

5/ See infra pp. 13-14.

6/ Fourth Report and Order in CC Docket No. 79-252 (Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities), 95 FCC 2d 554, 564, 573 (1983) ("Fourth Report").

7/ Id. at 564.

8/ Id. at 565.

9/ American Telephone & Telegraph Co., 89 FCC 2d 889, 897 (1982).

10/ Notice of Proposed Rulemaking in CC Docket No. 86-421 (FCC 86-548, released January 9, 1987) ("Deregulation NPRM"). The Commission's proposal proffers two categories of services as candidates for "streamlined" regulation: data services which are supported by packet switched networks ("packet services") and services provided under contracts awarded through a competitive bidding process ("contract services").

11/ See infra pp. 8-10.

12/ Deregulation NPRM, supra note 10 at ¶ 14. FCC Commissioner Mimi Dawson, in a separate statement accompanying the NPRM, disagrees with the proposed service-by-service approach for these reasons. Commissioner Dawson observed: "First, it is not clear that actual submarkets (or different product markets) can readily be identified. As digital technology becomes more widely deployed in the network, . . . it may be that supply and demand substitutability increases rather than decreases. Thus, the relevant product market may be expanding rather than contracting . . . . Second, an approach which relies on technical definitions such as proposed for packet services may not pass the test of time." Separate Statement of Commissioner Dawson at 2-3.

13/ AT&T, for example, allows customers to purchase bulk long distance service under either an optional calling plan such as Pro America or WATS, since the two services are technically identical. See AT&T Communications, FCC 86-240, released May 14, 1986. Similarly, the functional distinction between a multipoint private line service and MTS has largely disappeared with AT&T's introduction of "Software Defined Network Service," which allows a customer basically to construct a private line network using the shared facilities of AT&T's switched network. AT&T Communications, FCC 85-583, released November 7, 1985. AT&T has even proposed that the Commission take steps toward ending the cost reporting distinction between MTS and WATS categories, thus eliminating any vestigial basis for a contention that these services represent discrete submarkets. See Petition of AT&T to Modify the Interim Cost Allocation Manual, filed Jan. 27, 1987.

14/ *See* Integrated Services Digital Networks, 94 FCC 2d 1289 (1983). *See also* Separate Statement of Commissioner Dawson, *supra* note 12, at 2.

15/ FCC Deregulation NPRM, *supra* notes 10 & 12.

16/ NTIA Comments on FCC Deregulation NPRM at 4.

17/ AT&T Comments on FCC Deregulation NPRM at 5-7.

18/ *Id*. at 7.

19/ DOJ Comments on FCC Deregulation NPRM, filed Mar. 6, 1987 at summary. *See also id*. at 18.

20/ *Id*. at 19.

21/ *Id*. at 11.

22/ BellSouth Comments on FCC Deregulation NPRM at 12.

23/ BellSouth March 13 Comments at 34.

24/ Southwestern Bell Comments on FCC Deregulation NPRM at 8.

25/ Southwestern Bell March 13 Comments at 28.

26/ Pacific Companies Comments on FCC Deregulation NPRM at 13-14.

27/ Standard Oil Co. v. United States, 337 U.S. 293, 299-300 n.5 (1949). *See also* United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 395 (1956).

28/ As the Supreme Court held in Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962), "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use . . . between the product itself and substitutes for it. However, . . . well defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes."

29/ *E.g.*, United States v. Continental Can, 378 U.S. 441 (1964); United States v. E.I. du Pont de Nemours & Co., *supra*, 351 U.S. at 394 (1956). "Demand substitutes" are products that consumers perceive to be sufficiently close substitutes that a slight relative change in the price of one product will cause a shift in demand in another, while "supply substitutes" are products that may not be close demand substitutes for each other but which can be produced interchangeably from the same facilities. *See* P. Areeda & D. Turner, Antitrust Law 370-76 (1978).

30/ Fourth Report and Order, 95 FCC 2d at 564-65 (footnote omitted).

31/ United States v. FCC, 652 F.2d 72 (D.C. Cir. 1980).

32/ *See* United States v. AT&T, 524 F. Supp. 1336, 1346 (D.D.C. 1981).

33/ *See* MFJ, 552 F. Supp. at 170-73, 188-89, 227-29 (MFJ §§ II.D, IV.K).

34/ AT&T Comments at 47.

35/ *See* DOJ Report at 80; Huber Report at 3.9, Table IX.5.

36/ General Electric Comments at 8.

37/ DOJ Report at 80, 84.

38/ On March 27, 1987, Teleport Communications, a fiber optic network carrier providing interstate and intrastate service in the New York metropolitan area, petitioned the FCC for a declaratory ruling to compel New York Telephone (NYT) to permit collocations of Teleport's fiber facilities at NYT's central offices. *See* FCC Public Notice, Report No. DA87-399, rel. April 14, 1987; *Telecommunications Reports*, March 30, 1987 at p. 5. NYT and other BOCs have routinely refused interexchange carriers such collocated interconnections, forcing the carriers to pay unnecessary local transport fees for interexchange switched access. *See* Comments of National Telecommunications Network at 36-37. Moreover, the FCC's Third Computer Inquiry decision, 104 FCC 2d 958, 1042 (1986) requires BOCs voluntarily to adopt a collocation policy or otherwise work with Comparably Efficient Interconnection ("CEI") subscribers in good faith to minimize their transport costs for enhanced services. Nevertheless, under the first and only CEI plan submitted thus far, Bell Atlantic would assess outside subscribers *$9.30* in recurring monthly charges for business lines for message storage service but would charge itself only *$1.97* for the same service. Bell Atlantic's explanation for charging competitors 480% more for the same service is that "since these business lines are entirely within Bell Atlantic's central offices, the price Bell Atlantic imputes to itself is reduced to reflect the lack of a transport function." *See* Bell Atlantic, "Plan to Offer Comparably Efficient Interconnection," filed March 6, 1987, at n.8 & App. A.

39/ DOJ Report at 78. *See generally id.* at 78-97.

40/ *Id.* at 90-97.

41/ *Id.* at 92-93.

42/ *Id.* at 78-79, 93-94. *See also id.* at 5 (BOC opportunities for discrimination and cross-subsidization still exist "especially [as to] activities within a BOC's region").

43/ *See* BellSouth Comments at 44-46; Ameritech Comments at 61-62; FCC Comments at 31-44.

44/ FCC Comments at 33.

45/ BOC opportunities for collusion are exemplified by their integration of competitive efforts in a single, nationwide 800 Service database, developed by Bellcore at a cost of over $500 million. This "BOC 800 Service" will bundle enhanced capabilities such as 800 order entry, interexchange routing and information services in combination with basic 800 access capabilities. Such bundling of enhanced and basic 800 Service features has raised competitive concerns that the BOCs will cross-subsidize their provision of the enhanced features through monopoly revenues. Interexchange carriers would be disadvantaged by the BOCs' ability to provide such enhanced features at reduced prices made possible by funding of enhanced 800 service features at the expense of monopoly ratepayers. *See* "MCI Motion to Cease Deployment of Interexchange and Information Service Capabilities in BOC 800 Service Database," filed March 12, 1987; US Sprint Memorandum in Support of MCI Motion, filed March 30, 1987; AT&T Response to MCI's Motion to Cease Deployment of the BOCs' 800 Service Data Base, filed March 30, 1987.

46/ *See* COMPTEL Comments at 49-53. As the Court observed in a 1984 opinion rejecting the BOCs' requests for blanket waivers of all of the MFJ line of business restrictions, a BOC could transfer assets from monopoly to competitive ventures at less than cost or below fair market value. This would adversely affect both the monopoly ratepayers who in effect would fund the research and development costs of the transferred assets and the BOC's competitors who would be disadvantaged by the BOC's cross-subsidization. See United States v. Western Electric Co., 592 F. Supp. 846, 854 (D.D.C. 1984). For example, a BOC could develop certain assets ostensibly for its monopoly local exchange operations, but could use those assets to great advantage in a competitive market (such as interexchange service) which it anticipates entering in the future. The BOC could, with ratepayer revenues from the monopoly operation, "gold-plate" such facilities or services with features and capabilities not necessary for local service but which would be valuable in the competitive market. Once permitted to enter the competitive market, it could transfer the assets from its monopoly operations to the competitive activity. The BOCs' cooperative 800 Service database venture, described above, presents just such an opportunity. Indeed, on April 9, 1987, MCI filed a "Petition for Immediate Investigation" asking that the FCC take steps to determine whether the BOCs' costs of expanding their networks through database development, fiber optic network expansion and other activities which would support future BOC interexchange services, probably totalling in the billions of dollars, are being allocated and recovered in a lawful and reasonable manner.

47/ See, e.g., Comments of National Telecommunications Network at 15-16.

48/ See Huber Report at 3.45.

49/ Ameritech Comments at 61-62.

50/ See letter from Kenneth E. Millard, Senior Vice President and General Counsel, Ameritech, to Kevin R. Sullivan, Assistant Chief, Communications and Finance Section, U.S. Department of Justice, November 5, 1984.

51/ See letter from Kenneth E. Millard, Senior Vice President and General Counsel, Ameritech, to Kevin R. Sullivan, Assistant Chief, Communications and Finance Section, U.S. Department of Justice, June 4, 1986.

52/ Millard to Sullivan letter, June 4, 1986.

53/ Id.

54/ Huber Report at 3.39 n.134.

55/ Pacific Telesis Comments at 18.

56/ Id. at 18, n.26.

57/ FCC Comments at 29.

58/ Id., citing Report and Order in CC Docket No. 86-111 (Separation of Costs of Regulated Telephone Service from Costs of Non-regulated Activities), FCC 86-564, rel. Feb. 6, 1987 ("Joint Cost Order").

59/ Id. at 30. Some BOCs are already indicating resistance to numerous aspects of ONA and predicting that they will not be able to meet the FCC's February 1, 1988 deadline for BOCs' submissions of ONA plans. For example, the Vice-Chairman of Pacific Telesis recently asserted that ONA "taken to extremes" would unduly complicate and weaken the core telephone network, and stated that "it would be difficult" to reach an industry agreement on ONA by the FCC's deadline. Communications Daily, April 15, 1987 at p. 6.

60/ FCC Comments at 30.

61/ With regard to structural or accounting separation of BOC interexchange activities, BellSouth suggests that BOC entry into interLATA services through separate subsidiaries on an "interim" basis would be "an effective means of avoiding both discrimination and cross-subsidy concerns." BellSouth Comments at 42. However, historical experience teaches that such a mechanism will not effectively prevent anticompetitive behavior by BOCs in the interexchange services market. In its Second Computer Inquiry, 77 FCC 2d 384, 462 (1980) the FCC recognized that "[a] separate subsidiary requirement . . . does not guarantee a competitive marketplace because it does not significantly change the incentives of a firm upon which it is imposed. . . . [I]f the parent has an incentive to exercise its market power to the disadvantage of consumers and competitors in the absence of a separate subsidiary, it has the same incentive to do so after one is required." Similarly, in adopting the MFJ, this Court observed that "if cross subsidization is a problem, a separate subsidiary will not resolve it." MFJ, 552 F. Supp. at 173. More recently, in eliminating structural separation requirements for both AT&T and the BOCs, the FCC observed that the BOCs' anticompetitive opportunities were constrained somewhat *because* they were prohibited from offering interexchange services. *See* Third Computer Inquiry, 104 FCC 2d 958, 977, 999 (1986). It appears evident, then, that creation of separate subsidiaries to provide in-region or out-of-region interexchange services would be inadequate to prevent anticompetitive BOC behavior.

62/ Response of the United States to Public Comments on Proposed Modification of Final Judgment, filed May 20, 1982, at 57.

63/ See COMPTEL Comments at 31, citing Statement of Chairman Fowler before the House Appropriations Subcommittee on the Department of Commerce, Justice and State, the Judiciary and Related Agencies, Feb. 25, 1987.

64/ *See, e.g.*, Notice of Proposed Rulemaking in CC Docket No. 86-421, *supra* note 10 (proposing to apply streamlined regulation or forbearance to certain basic services); Third Computer Inquiry, *supra* note 61 (removing BOC structural separation requirements).

65/ NYNEX Comments at 8; Ameritech Comments at 10-11 and Att. A.

66/ *See* Economics and Technology, Inc., "Factual Predicates to the MFJ Business Restrictions -- A Critical Analysis of the Huber Report," March 13, 1987 (hereinafter the "ETI Report"), appended to Joint Comments of the Ad Hoc Telecommunications Users Committee and International Communications Association, at 68-72.

67/ Joint Cost Order, *supra* note 58.

68/ *Id.* at ¶ 203.

69/ ETI Report, *supra* note 66, at 72.

70/ *Id.* at 69-70.

71/ *See* Comments in re Annual 1987 Access Charge Tariff Filings, Oct. 28, 1986, filed by COMPTEL, ALC Communications Corporation, US Sprint Communications Company, MCI Telecommunications Corp.

72/ *See id.* at 71, citing Request for OMB Review, "Demand Reconciliation Study," submitted December 1, 1986, and letter from F.S. Reeder, Chief, OMB Information Policy Branch to E.J. Minkel, Managing Director, FCC, dated February 17, 1987.

73/ United States v. GTE Corp., 603 F.Supp. 730 (D.D.C. 1984).

74/ 603 F.Supp. at 737.

75/ *Id*. at 734.

76/ BellSouth Comments at 41-42, citing Huber Report at 3.51 n.165.

77/ 603 F.Supp. at 734.

78/ *Id*. at 737.

79/ U S West Comments at 23.

80/ AT&T Comments at 51 n.*.

81/ *Id*.

82/ *Id*. at 3.

83/ Bell Atlantic Transmittal No. 113, filed Oct. 3, 1986, Cost Support Vol, 5, pp. 1-4, 5.

84/ *Telephony* Magazine, Jan. 19, 1987 at 44 (interview with NYNEX Chairman Delbert Stanley).

85/ *E.g.*, NYNEX Comments at 4.

86/ *See* COMPTEL Comments at 15-19.

87/ NYNEX Comments at 6.

88/ Huber Report at Table IX.7.

Senator **Metzenbaum**. Thank you very much, Mr. Hoffman. Mr. Johnson, our last witness today, we will be happy to hear from you.

Mr. **Johnson**. Thank you, Mr. Chairman. I appreciate the opportunity to appear before the Subcommittee today to present the views of the American Newspaper Publishers Association on the Department of Justice recommendations to lift the information services restriction, in particular, which is imposed on the Bell Operating Companies under the MFJ. ANPA members advocate a competitive and a diverse electronic publishing market, electronic publishing being a subset of the broader information services market.

ANPA opposes the Department of Justice recommendations to lift entirely the information restriction services for four basic reasons.

First, as we have heard many times this morning, there have been no changes in the basic bottleneck market which would justify the sweeping reversal of policy by the Department of Justice, just three years after divestiture.

The BOCs still retain nearly a 100 percent bottleneck control of local telephone service, and they have the same incentive and ability to act anticompetitively by discriminating against electronic publishers.

A 1987 study by the Department of Commerce's NTIA documents that there is no alternative way for a real-time interactive phone network to provide electronic publishing, and Mr. Rule just conceded this morning, that the bottleneck, at least into the home, the twisted pair, will continue.

Second, the BOCs also retain the ability to cross-subsidize these new electronic publishing services with revenues from their monopoly service. The end result of cross-subsidization will be higher costs to the consumer.

Third, Mr. Chairman, the electronic information market is growing. Newspapers, frankly, represent a very small portion of the electronic publishing market. Many other companies, both large and small, are involved in publishing information over telephone lines.

In fact, contrary to what we have heard this morning, the U.S. is the world leader in electronic publishing. The current MFJ restrictions have not and will not preclude more widespread development of electronic publishing. The only thing that will is an uncertainty of whether or not the BOCs will be able to enter into that market.

Fourth, entry by the telephone companies into electronic publishing with the serious potential for anticompetitive conduct could, and we believe would, stifle further development of this new medium, and reduce the diversity of voices to the detriment of the American public.

In 1982, ANPA participated in the public comment proceeding on the consent decree before Judge Greene. We argued to the court then, and we submit to you today, that sound antitrust and First Amendment considerations dictate that the monopoly owners of the bottleneck, the telephone transmission facilities, should not be allowed to own, or in any way control the information that flows over those facilities.

The underlying reason for the restrictions on the BOC provision of information services was their nearly 100 percent control of the local telephone lines.

Judge Greene found that the BOCs' bottleneck control gave them the same incentives, and the same ability to discriminate against competing information service providers as the BOCs would have with respect to interexchange carriers.

Building on those sound antitrust concerns the Court, in the MFJ, also recognized that the entry of the BOCs into electronic publishing, and the potential for stifling a diversity of information services over this new medium raised significant First Amendment concerns.

Let me be more specific about the ways the BOCs could discriminate against competing electronic publishers. A phone company could give its own electronic publishing operations more favorable access to the network the way AT&T did with long-distance services.

The phone company could also discriminate in the implementation of network enhancements, and the provision of network and customer information to its own operations that is denied to competitors, or provided later, or on a less favorable basis.

The potential ability for the BOCs to cross-subsidize these new information services with revenues from monopoly services is not speculation.

I will end my formal testimony here. Thank you, Mr. Chairman.

[The prepared statement of Mr. Johnson follows:]

WRITTEN TESTIMONY

of

ROBERT M. JOHNSON

PRESIDENT, PUBLISHER AND CHIEF EXECUTIVE OFFICER

NEWSDAY
(LONG ISLAND, NEW YORK)

VICE CHAIRMAN, ANPA TELECOMMUNICATIONS COMMITTEE

Representing the

AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION

Before the

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

COMMITTEE ON THE JUDICIARY

On

PROPOSED MODIFICATIONS TO THE AT&T DECREE

U.S. SENATE

APRIL 30, 1987

Mr. Chairman, I appreciate the opportunity to appear before your subcommittee today to present the views of the American Newspaper Publishers Association on the Department of Justice recommendations to lift the information services restriction imposed on the Bell Operating Companies (BOCs) under the Modification of Final Judgment (MFJ).*/ The American Newspaper Publishers Association represents approximately 1400 newspapers, accounting for more than 90 percent of the daily and Sunday circulation in the United States.

ANPA members advocate a competitive and diverse electronic publishing market - electronic publishing being a submarket of the broader information services market. News, political views and information, editorial views, advertising, product and service information, many financial services, educational material, transactional services, sports reports and religious information and views, in either voice or data form -- all fall within the definition of electronic publishing.

ANPA opposes the Department of Justice's recommendation to lift entirely the information services restriction. There have been no changes in the market that would justify this sweeping reversal of policy by the Department, just three years after divestiture.

In 1982, ANPA participated in the public comment proceeding on the AT&T consent decree, conducted by Judge Greene. We argued to the court then and we submit to you today that sound antitrust and First Amendment considerations dictate that the monopoly owners of the bottleneck telephone transmission facilities should not be allowed to own or control the information that flows over those facilities.

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*/ (United States v. American Telephone and Telegraph Company, 552 F. Supp. 131 (D.D.C. 1982), aff'd mem. sub. nom. Maryland v. United States, 460 U.S. 1001 (1983).

The underlying reason for the restriction on BOC provision of information services was their control of nearly 100 percent of the local telephone lines within their service areas. Judge Greene found that the BOCs' bottleneck control gave them the same incentives and the same ability to discriminate against competing information services providers as the BOCs would have with respect to interexchange carriers.

Building upon those sound antitrust concerns, the Court in the MFJ also recognized that entry of the BOCs into electronic publishing -- and the potential for stifling a diversity of information sources over this new medium -- raised significant First Amendment concerns.

BOCs' Bottleneck Control over Local Telephone Service

Mr. Chairman, the bottleneck persists today, and so do the BOCs' incentives and abilities to discriminate and cross-subsidize. We disagree with the assertion of the Department of Justice that there has been a technological erosion of the bottleneck with respect to electronic publishing. The Department finds that there is a bottleneck and a potential for anti-competitive conduct for purposes of interexchange services, but not with respect to information services.

Well, Mr. Chairman, it's the same bottleneck.

There is only one local phone company line when I want to make a long distance call or dial up CompuServe on my personal computer. A recent study of competition in the local exchange telephone service market, by the Department of Commerce's National Telecommunications and Information Administration, found that today there are no meaningful alternatives to the two-way, interactive phone networks for the provision of most electronic publishing. Yet in its recommendations, the Department of Justice cavalierly dismisses the "bottleneck" and the BOC's potential for monopoly mischief with undue reliance on illusive regulatory safeguards.

Discrimination

Let me be more specific about the ways in which the BOCs could discrminate against competing electronic publishers.

A phone company could give its own electronic publishing operations more favorable access to the network. Who controls the priorities for switching and access to trunk lines? Who controls whether a call gets direct or indirect routing? Who controls over which physical facilities the calls travel? Who controls the quality of the call? Who controls when an electronic publisher gets new or restored service? The answer to all of these questions is the BOC. For time sensitive electronic publishing services, issues such as how quickly a service obtains necessary network services, the quality of the underlying transport, and the length of time for dial up and responses to inquiries may be critical to its success or failure.

The phone company also could discriminate in the implementation of network enhancements and provide network and customer information to its electronic publishing operations, that is denied to competitors, or provided later or on less favorable terms and conditions. For example, the phone companies are in a unique position as the owners of the local exchange networks to have far better access to information on network traffic patterns, information on their competitors use of the network and sensitive business information on their competitors' operations. Access to this information will give them a tremendous advantage over their competitors, especially in the development of new services and marketing efforts.

Some phone company practices related to 976 audiotex*/ services illustrate the control that the BOCs, exert even today over electronic publishing services -- although their role is technically limited to provision of the transmission facility. Several BOCs in fact peg the price charged for a 976 call to the amount charged to the caller for the information. This gives them an indirect financial interest in such information. Additionally, some BOCs set call minimum requirements. If the information provider does not receive a certain number of calls a month, this service is terminated. When such a service is terminated, there is no other option. Despite the Department of Justice's assertion, there is only one game in town when it comes to provision of electronic publishing via phone lines. The BOC's exercise of their market power in the area of audiotex services suggests the serious risks involved in allowing the BOC to offer electronic publishing services over their own facilities.

In its March 13, 1987 filing with Judge Greene, Dun and Bradstreet, a publisher of printed directories, cites the failure of certain BOCs to provide certain printed directory information and updates as an example of the potential for BOC anti-competitive conduct against competitors by virtue of their local exchange monopolies.

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*/ Audiotex services are electronic publishing services in audio form. They run the gamut from a consumer calling and listening to a sports score to a very sophisticated interactive voice response system. Normally, a consumer dials a 976 number and the BOC transmits the call to an electronic publisher whose message is stored on its own premises, retrieved and then transmitted back to the caller. Billing is handled by the BOC.

If the phone companies are allowed to enter the electronic publishing marketplace today, and discriminate against a still fledgling, struggling group of electronic publishers, the ultimate loser will be the American consumer. In keeping with First Amendment principles, our country has long been committed to a diversity of information sources for its citizenry. As recognized by the Court in the MFJ, entry of the phone companies into electronic publishing could stifle the development of this new medium and reduce the diversity of voices to the detriment of the American public. Such an outcome would serve poorly our national commitment to free expression.

Cross-Subsidization

The potential ability for the BOCs to cross-subsidize these new information services with revenues from monopoly services also poses a serious threat to the consumer. This is not mere speculation. In a June 1986 report,the California Public Utilities Commission found evidence of Pacific Bell's cross-subsidization of unregulated services with rate base revenues in the areas of personnel and property transfers. The California PacTel situation does not appear to be an isolated one. A National Association of Regulatory Utility Commissioners (NARUC) publication found that state regulators generally have similar concerns about BOC practices.

A drain of the ratebase to subsidize unregulated services inevitably will lead to increased costs for local telephone service. In 1985, the BOCs unregulated subsidiaries lost nearly one billion dollars according to data submmitted to the FCC. Newspaper companies, including my own, know from experience that the road to success in electronic publishing has not been paved with gold, but with red ink. It is because of this fragility that the electronic publishing market is even more susceptible to anti-competitive conduct.

Inadequacy of Safeguards

The Department of Justice would have us rely on the FCC's regulatory safeguards to prevent anti-competitive conduct. Unfortunately, FCC regulatory safeguards have proven inadequate in the past to prevent anti-competitive abuses.

The FCC looks to a concept termed open network achitecture (ONA) as a way to give information providers access to the network, and remove any potential for discrimination by the BOCs. For ONA to remove the anti-competitive potential, there must be true equal access. It does not exists today and may never exist. ONA today is conceptually an attractive idea which can be tested only through its application. Safeguards are too important in this fragile market to assume that appealing ideas can be presumed to provide adequate protection against anti-competitive actions.

Furthermore, the FCC rejection of cost averaging as a cornerstone of its Computer III rule is prima facie evidence of the inadequacy of the current ONA scheme. As a case in point, Bell Atlantic recently filed a CEI plan with the FCC under which it proposes to offer a voice storage service, charging itself $1.94 for a business line and its competitors $9.30 -- a difference of $7.36.

The FCC proposes to handle the cross-subsidization problem with new accounting rules. Well, Mr. Chairman, the historical failure of accounting rules to prevent cross-subsidization is well documented. We remain unconvinced that such rules will be able to do the job today.

The fallacy of the new accounting rules is illustrated by looking at their treatment of joint marketing:

> I call my local BOC to get a new phone installed. The customer "rep" takes my order, and then suggests a whole range of electronic publishing services offered by the phone company. Under these new FCC accounting rules, the only charge to the unregulated side of the ledger would be the labor cost related to the amount of time the customer rep discusses the new electronic publishing service with me. The use of the BOC's name and the shared facilities would not be charged to the unregulated electronic publishing service.

Mr. Chairman, it will be extremely difficult for the FCC, competitors or others adequately to police the accounting rules, especially given the limited staff resources in this climate of budget restrictions. The FCC's decision to not require a uniform method of reporting for the seven BOCs will make their job even more impossible. The FCC proposals to address the BOC's superior access to a range of customer and network information are also inadequate.

The U.S. -- A Leader in Electronic Publishing

ANPA disagrees with the Department of Justice's assertion that the American consumers are being deprived of electronic publishing services available in foreign countries. The U.S. is a world leader in electronic publishing measured by general availability of services and technology development.

The U.S. far exceeds other countries in the use of professional on line database services as measured by revenues. (See Appendix A) The U.S. also holds a leadership position for consumer-oriented electronic publishing services, and exports three times as much electronic information as is imported into the U.S.

The current MFJ restrictions do not preclude more widespread development of electronic publishing in the United States. The perceived slow development of the electronic publishing market can be attributed to a lag in consumer acceptance and other market factors.

Mr. Chairman, the electronic information market is growing. Newspapers represent but a small portion of electronic publishing market. Many other companies both large and small are involved in publishing information over telephone lines.

Diversity in the Electronic Publishing Market

Although the electronic publishing market continues to expand, it remains at a stage where its competitiveness easily could be destroyed by BOC anticompetitive behavior. The development of electronic publishing must be viewed with particular concern, because of the critical First Amendment values in a diversity of voices. The likely consequences of the Department's proposal, given the inadequacies of current regulations, will be a drastic inhibition of the potentially large number of electronic information services available to the American public -- and First Amendment values utterly ignored by Department of Justice will thereby suffer.

ANPA concerns regarding BOC entry into information services, and in particular, electronic publishing, are directly related to their virtual 100 percent bottleneck control of local phone lines. The fact that there are seven of them does not change the reality that each one of them has bottleneck control over nearly all local exchange service within its region.

As long as they each hold this position, their role in the electronic publishing market should be one of a provider of the underlying transmission and related services. This removes the serious threat of discrimination and cross-subsidization and provides the best guarantee of a diversity of information sources for the American consumer.

ANPA Comments on Department of Justice Recommendations

In its March 13 filing with Judge Greene on the Department of Justice's Recommendations to lift the MFJ restrictions, ANPA urged the Court to adopt as a critical criterion for BOC monopoly power in the electronic publishing market the availability to electronic publishers and their customers of non-BOC transmission alternatives functionally equivalent to BOC exchange service. ANPA suggested a useful measure to assess bottleneck control would permit BOC entry if at least 25 percent of customers in an area receive local exchange service from a non-BOC.

ANPA recognizes that the offering of electronic publishing services by one of the seven Regional Companies outside of their region would not raise the same level of concern about anti-competitive conduct because the BOC would not provide the service over its own bottleneck facilities. However, ANPA believes that adequate safeguards against cross-subsidization should be defined, implemented and proven effective, before the Court should allow BOC entry into out of region electronic publishing.

In the case of information services that do no involve control of or interaction with content (non-electronic publishing services), ANPA recommended a case by case analysis by the Court so that the court can assure itself that effective safeguards will preclude anti-competitive behavior.

Department of Justice/Proper Forum for Enforcement of the MFJ

Mr. Chairman, ANPA has filed comments in sixteen waiver proceedings and also brought several instances of potential MFJ violations to the attention of the Department of Justice. In several cases, the Department has very quickly moved to enforce the decree. For example, on April 1, the Department of Justice found that U.S. West's operation of an economic forecasting service was in violation of the MFJ services and ordered U.S. West to cease offering the service. */

While disagreeing with the Department's reversal of policy on lifting the MFJ restriction on information services, we nevertheless believe that the responsibility for antitrust enforcement of the MFJ properly lies with the Department of Justice, including the review of MFJ waiver requests. The MFJ is an antitrust decree whose purpose is the prevention of anticompetitive conduct by dominant telephone carriers. As the executive branch agency charged with primary responsibility for antitrust enforcement, the Department of Justice remains the appropriate forum for enforcement of that decree.

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*/ However in the case of Phone Programs, Inc.'s request for investigation and enforcement of the MFJ with respect to potential violations of the MFJ in the provision of audiotex services, to ANPA's knowledge, the Department has not taken any action.

ANPA urges the subcommittee to continue its oversight of the Department's enforcement of the Decree, and to oppose any legislative efforts to lift the MFJ restrictions on information services.

Mr. Chairman, we thank you for holding this hearing today.

APPENDIX A

On a comparative basis, the electronic publishing services listed in the Huber Report are not more widely available in other major industrial countries than they are in the U.S. For example, the U.S. far exceeds other countries in the use of professional on-line database services as measured by revenues:

On Line Professional Database Revenues[1]

Country	Total Revenue ($ million)	Per Capita Revenue
U.S.	2,090.0	$8.75
France	131.7	$2.38
West Germany	87.2	$1.43
Japan	832.3	$6.89
Netherlands	39.4	$2.72
United Kingdom	316.1	$5.59

The U.S. also holds a leadership position for consumer-oriented electronic publishing services (videotex), as shown in the following table:[2]

GENERAL INTEREST VIDEOTEX

Country	Subscribers	Market Penetration
U.S.	522,500 +	0.6%
FRANCE	600,000[3]	1.1%
WEST GERMANY	52,000	0.2%
JAPAN	20,000	0.04%
NETHERLANDS	20,000	0.02%
UNITED KINGDOM	73,000	0.1%

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[1] Communications Studies and Planning (CSP)International, 24 East 21 Street, New York, New York 10010

[2] CSP International

[3] This figure does not include terminals reported used only for the telephone directory feature. The total number of terminals is approximately 2 million.

The French Minitel system's greater apparent market penetration is due in large part to free distribution of terminals by the government-owned telephone company. The German and British systems have only niches in the business and professional electronic publishing markets. The Japanese and Dutch systems have had similar results.

The U.S. general videotex market is larger in absolute size than the French, and offers a comparable range of services. DOJ evidently fails to appreciate that the videotex function in the U.S. is performed by services that are classified as on-line databases in the Huber Report (Section 7.1). In fact, services such as the Source, CompuServe and Quantum Link, as well as services offered by banks, brokerage firms, and other companies, perform exactly the same functions as those available to France via the Minitel terminals, including airline reservations, home shopping, banking, electronic mail, stock brokerage, and the popular "on-line chat" services for which Minitel is famous.

America's leadership in electronic publishing is also demonstrated by the U.S. trade balance in provision of electronic publishing services. Europe imports from the U.S. three times as much (in value) electronic information as it exports to the U.S. market. About 50 percent of the volume of information services sold in Europe in total are from major American providers, including Lockheed Dialog, DRI, and Mead Data Central.[4]

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[4] CSP International

Senator METZENBAUM. Thank you very much. I have a few questions.

Mr. Spratley, what will happen to rates in Ohio if the restrictions on Ameritech are lifted, and why?

Mr. SPRATLEY. Well, our concern is the cross-subsidy issue. I have enclosed with my testimony, Attachment Number 3, where in a Bell case, we asked an interrogatory of Ohio Bell, we asked about Ameritech, and Ohio Bell objected, saying that the word Ameritech was "vague and indefinite" to them.

So, we have a problem at the State level, of simply getting the records from the regional holding company to determine the cross-subsidy issue, and I think that is a difficult problem for State regulation in this whole arena and which is why we, as an office, believe that if you are going to really look at the costs, it is better to place the regulation at the State level, where the State could have control over Ohio Bell totally, rather than having to try to reach across to Chicago and get that information.

We believe that, you know, with the—we asked for the Ameritech table of organization in a rate case discovery request, and we were told by Ohio Bell that that was irrelevant. This is what happened in the actual legal proceeding.

So to get to these costs we have this barrier set up at the State level, and so it becomes very difficult.

Senator METZENBAUM. Maybe Mr. Millard could explain why Ameritech is a vague and indefinite word to Ohio Bell people, and also why his people are so difficult to work with as far as getting something as elementary as a table of organization.

[Aforementioned material was subsequently supplied for the record.]

Office of the
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May 26, 1987

Mr. Paul Guller, Chief Printer
Senate Committee on the Judiciary
Russell Senate Office Building
Room SR-374
Washington D.C. 20510

Re: Transcript Corrections
for April 30, 1987 Hearing

Dear Mr. Guller:

Per your written request, I have enclosed the corrected copy of the transcript of my testimony before the Senate Judiciary Subcommittee on Antitrust. Also, I have enclosed a copy of the Ohio Bell response to my office's discovery request, which I referred to on page 96, lines 20-23 of my testimony and to which Senator Metzenbaum referred on page 97, lines 3-4.

Please let my know if I may be of additional assistance. Thank you.

Sincerely,

WILLIAM A. SPRATLEY
Consumers' Counsel

WAS/nj
Enclosure

OCC REQUEST FOR PRODUCTION OF DOCUMENTS NO. 4

77. Please provide an organization chart for Ohio Bell and its regional holding company Ameritech, showing both regulated and nonregulated business areas.

The requested document is not relevant nor reasonably calculated to lead to the discovery of admissable evidence. Ohio Admin. Code §4901-1-16(B).

Mr. **Millard**. Mr. Chairman, I really cannot respond to the detailed background of the legal proceeding that apparently is being referred to here, with the limited context that I have been given.

I can say that we operate broadly two different businesses. One is a regulated public utility business, and another one is an unregulated fully competitive business. And we have taken great pains to make sure that there is no cross-subsidization between the two.

I might add, that I think that the cross-subsidization issue is an issue that was visited upon AT&T for years, when the world was characterized by AT&T and a lot of small competitors.

Today, since divestiture, the world is characterized by AT&T, a bunch of other large competitors, where it makes no sense for a company like ours to cross-subsidize, to lose money in the market.

Senator **Metzenbaum**. I am not sure how we got into this question of cross-subsidization because I was only asking about the table of organization, and also why Ameritech is a word that was not known. I was not sure how we got into that part of your response.

Mr. **Millard**. I am sorry. I thought you were asking whether we had a policy of cross-subsidization.

Senator **Metzenbaum**. No, no.

Mr. **Millard**. That was how I had interpreted your question.

Senator **Metzenbaum**. Because I do not think Mr. Spratley made that assertion. I think that he said that he was trying to find out the facts and before he could come to that conclusion, I think he was looking for the facts, and could not even get a table of organization, or even any recognition of the relationship between Ohio Bell and Ameritech.

Apparently that is what you were saying, that they did not know what the word meant.

Mr. **Spratley**. Yes, and I do believe that the whole possibility of—I think it is greater than a possibility. I think the cross-subsidization is the greatest danger we face.

Senator **Metzenbaum**. Let me ask you this question. Mr. Spratley, you have been the Ohio Consumers' Counsel for ten years. Do you think that the Ohio ratepayer is getting the same service from Ohio Bell that it was getting before divestiture?

Mr. **Spratley**. If they pay more for it, they probably would get it. What we have seen is an unbundling of the rates. For example, before the break-up, you could make three free directory assistance calls. Now you cannot. The rates are up at the local level 39 percent more.

We have the whole mass confusion over inside wiring, which is a negative enrollment plan. If you do not want it you have to sign to take that 20 cents off of your bill.

Senator **Metzenbaum**. What is that for, the 20 cents?

Mr. **Spratley**. This is for the inside wiring which is part of the whole unbundling of the phone rates as it is called, and we have confusion, mass confusion, as I talk to consumers all over the State as to what is now included in their bill. Should they buy an insurance policy, so to speak, from Ohio Bell, what they call the linebacker plan, which would assure against something happening to the inside wiring?

Although in most cases, consumers would never have something happen to the inside wiring of their house. This is the kind of confusion that has been visited on consumers. My personal opinion, Mr. Chairman, is that some day in this country the American people are going to wake up, and they are going to see that they are not better off than they were before deregulation, and I think we can see it clearly in what has happened to the phone rates.

And what I have shown you is what the rates are, what they were three years ago, and what they are now.

Senator METZENBAUM. I think I may have misstated the case when I said that I thought the basic phone rate in Ohio was $37. I think that is not the case. Can you tell me what the facts are as to what the basic phone rate is?

Mr. SPRATLEY. If you look at attachment number 2, we have not looked at long-distance. We are looking simply at local exchange rates. Ohio Bell, at the time of the break-up, was $14.88. It is now $20.41, or $5.53 more. Two dollars of that is the access charge, and that is scheduled to go up to $3.50. $2.50 of that increase came from the PUCO in rate increases.

There is a 75 cent increase in the instrument charge charged by AT&T, and most customers still rent a telephone.

Senator METZENBAUM. That is per instrument?

Mr. SPRATLEY. Right.

Senator METZENBAUM. Each additional instrument is 75 cents, or more?

Mr. SPRATLEY. It has gone up 75 cents over that three-year period.

Senator METZENBAUM. What was it, and what is it now, do you know?

Mr. SPRATLEY. I believe it is about a $1.75 rental charge per month.

Senator METZENBAUM. So that if it was a dollar, it is now $1.75.

Mr. SPRATLEY. The customer, the consumer—and we try to educate consumers to this—could avoid this charge by buying a phone instead of renting the phone. The difficulty is, in the survey data we have seen, most people are still renting it, and particularly the people who can least afford to pay, senior citizens, for example. Survey after survey have shown consumers still are renting a telephone rather than buying it.

They have not taken advantage of competitive long-distance, if they make long-distance calls, which most residential consumers are not big users of long-distance calls.

So, you know, this is the kind of data that I think this Committee should be aware of, is what does the average consumer see on the telephone bill? There are 4 million people that see these kinds of increases and know that their bills have gone up 40 percent in the State of Ohio.

Senator METZENBAUM. Do you think, Mr. Spratley, Ohio's utility regulators will be equipped to police cross-subsidies by the Bell Companies if they are permitted to enter long-distance?

Mr. SPRATLEY. No, I do not. I think the record is clear that the PUCs, and the one in Ohio in particular is understaffed. We do not have a strong affiliated interest statute as the Chairman of the Washington Commission alluded to in the State of Washington.

Our experience has been that the PUCO has not dealt with this directly. It has deferred the issue of looking at these cross-subsidies in the Cincinnati Bell case, and I am very concerned about the ability at the State level.

And what frightens me even more, Senator, is the ability of the FCC to suddenly decide to regulate in this area. It seems to me that we have much less faith there than we do in our own State regulators, and I think that they at least are willing to address the issue, but I have to say, I think they are going to be overwhelmed with the myriad of cross-subsidies we could possibly look at.

Senator **METZENBAUM**. Mr. Millard, the National Association of Regulatory Utility Commissioners said last year that Ameritech has now joined the "business waiver derby", and apparently intends to diversify into long-distance and manufacturing.

It also found—and I quote—that, quote: "Some of the costs associated with the existence of Ameritech itself were not appropriately allocated. That is, the costs of activities that benefit the shareholders. In other words, shareholder affairs, lobbying, corporate communications, securities servicing, and certain executive expenses should be absorbed by Ameritech and thus charged to the shareholders, and not allocated to the BOCs." End of quote.

Can you tell us, what are some of the lobbying and executive expenses that Ameritech was found to have charged to its telephone subsidiaries?

Mr. **MILLARD**. I believe that audit refers to expenses of our corporate relations program and our investor relations program.

Ameritech took the position that whether you have a holding company or whether you have to deal with shareholders directly from a public utility, that is a proper expense of doing business.

Issues as to proper levels of expenditures of that type have been with us as long as there have been public utilities, and regulatory agencies. They are relatively small expenditures compared to the overall expenditures of any of our companies, but there were some disagreements on those, yes.

Senator **METZENBAUM**. Do you think that I, as an Ohio ratepayer, ought to pay for your lobbying activities in connection with the matters pending in this Congress, or matters before the court, when you are really attempting to raise my rate, and the rates of all other users of your services?

You come down here. My guess is that you charge this as a part of the corporate expense, and it goes into the rate base.

How do you make the distinction between what is my charge as a ratepayer, and your responsibility as far as representing the shareholders is concerned?

Mr. **MILLARD**. Well, Mr. Chairman, if our efforts here today, and elsewhere in Washington on this issue, were to convince you that we could provide information services, such that we could provide voice messaging services to our customers for $5 a month, rather than the $40 a month it costs them today by going through telephone answering bureaus; and if we charged you some pro-rata share, one 4/millionths of the expenditure to accomplish that freedom, most ratepayers in Ohio would probably view that as a worthwhile expenditure and not object.

Senator METZENBAUM. Do you think most ratepayers in Ohio would like to have their money spent so that—you are only here in order that you can figure out a way to expand your operations, expand your operations to increase the shareholders' profits, a perfectly legitimate operation, perfectly legitimate activities, and perfectly legal activities on behalf of an American corporation?

The question that I am asking is, Should your ratepayers be charged with those lobbying activities, the funds that you are spending down here? Should that be a part of your rate base, and should you have the right to include it in your rate base? You talk about some way you might make some more profit, but there is not any indication at all that you would benefit the users. Quite the contrary, you will hurt the users because your rates will go up.

Mr. MILLARD. Mr. Chairman, I believe that if these senseless restrictions were lifted from my company we could provide much better service at a much lower cost to these ratepayers, and I would leave it to you as to whether that would be a prudent expenditure on the part of the ratepayers.

If it is not, the State regulators and Federal regulators have shown that they know how to compute those charges, and disallow them when the public utility rates are set.

Senator METZENBAUM. And how do you crank those rates back to Ohio Bell? How do you work those rates back so that they are allocated to the various different utilities?

Mr. MILLARD. Today, expenditures of educating public officials would be allocated among our five telephone companies, and also, among our other companies who might be benefitting from that activity.

Senator METZENBAUM. And that would include your lobbying activities?

Mr. MILLARD. Yes.

Senator METZENBAUM. Mr. Spratley, it seems to me it is an interesting point that should very appropriately be raised, and maybe you have raised it at the Public Utilities Commission in Ohio, and it just seems to me that Mr. Millard is very candid in saying, yes, we do claim it is a part of the rate base and we want to get an allowance for it.

Mr. SPRATLEY. I think Mr. Millard is correct that under Ohio ratemaking lobbying expenses will be disallowed. The difficulty, Senator, is having a rate case, number one, to disallow them.

If you do have the case, the difficulty is getting the information from Ameritech. We have to get it through Ohio Bell. I will say that today, in Columbus, the 13 major utilities are filing their annual reports, which is the only time each year, Senator, that we actually can see what Ohio Bell's profit level is.

In the last Ohio Bell rate case several years ago, the Commission authorized Ohio Bell to earn 14.58 percent return on equity. The figures from their annual report for 1986 show that their earned return on equity is 15.9, 130 basis points more than what the PUC allowed them to earn.

So while they are here today claiming—Ameritech is claiming that these companies need to have these restrictions lifted, the fact is that in Ohio, Ohio Bell is earning more than what it was authorized to earn in the last rate case.

So from where I sit, they are probably not just healthy, they are probably overfed, and I think, you know, from our position, it is clear that they have benefited, profit-wise, from the whole breakup, and I think many people could argue that AT&T, and others, probably did not, and that was something that most of us did not expect.

Senator METZENBAUM. Mr. Millard, Bell Companies say that allowing them to manufacture will create jobs and help alleviate the trade deficit.

I want to say to you that you ought to bring your instrument and join the orchestra, because there is nothing around the Congress these days that people do not tell us, if you will just pass this bill it will help alleviate the trade deficit. It is good for our foreign trade. I do not care what it is, no matter what the issue, everybody comes in and gives us that same "song and dance".

So I say to you that I guess I would have thought it was odd if you did not come in and claim that you would help to alleviate the trade deficit. But what we now find is that American companies, when they are healthy, and when they are making money, and they are doing the job, they still take their operations overseas, and we see Japanese companies, four of them coming into my own State, and operating in my State, manufacturing and making money.

What assurance do we have that if you were permitted to go into manufacturing, for example, that you would not just joint venture with foreign manufacturers, or you would not buy all your products overseas?

Mr. MILLARD. Well, I guess what I have to offer you, Mr. Chairman, on that question is the record in the four years since divestiture.

In the four years since divestiture, Ameritech has invested in technology of eight separate companies. Each one of the eight has been a domestic American company. Each one of them is bringing technology to the marketplace that we believe they would not have brought to the marketplace, absent our support of their technology.

On the other hand, since divestiture, as you know, the trade deficit has gone from $580 million to $1.9 billion in the red. Half of all PVXs and all handsets sold in the U.S. are manufactured overseas.

AT&T has laid off thousands of manufacturing workers. That record is not attributable to a regional holding company because we have been barred from the playing field.

In terms of what we would do, we have a definite regional interest in manufacturing, not just domestically, but in our region, where we can touch and feel the product, where we can hold people accountable if our large switching machines do not work, where we can get the service and maintenance personnel there on short notice if one of our machines serving millions of customers stop us functioning.

Both our incentive and our record indicate that we would, and have, indeed, supported domestic manufacturing, where the other players, quite frankly, are going in the opposite direction.

Senator METZENBAUM. Would you be willing to put into the record, in the case that is pending, that Ameritech would stipulate that if they are permitted to manufacture, that all manufacturing would be done in this country?

Mr. MILLARD. Mr. Chairman, if that is the condition that it would take for us to be able to work more closely with our suppliers to develop technology, we would take the position that, yes, indeed, that is a worthy start.

Senator METZENBAUM. The answer is yes?

Mr. MILLARD. Yes.

Senator METZENBAUM. Mr. Hoffman, are you here today representing Sprint, or representing CompTel, or both?

Mr. HOFFMAN. Both. I am here as chairman of CompTel but Sprint is an active member of CompTel and I never forget who signs my paycheck.

Senator METZENBAUM. Okay. How many of your members have entered the long-distance field since divestiture?

Mr. HOFFMAN. I was trying to remember the latest count. We have between 140 and 150 members. How many have entered the field since the divestiture which occurred three years ago? I can speculate, I can go back and try to find out for the record. I would guess, oh, a third, 20 to 30 percent maybe.

Senator METZENBAUM. What effect would lifting the long-distance restriction have on your members?

Mr. HOFFMAN. It would be devastating to competition. The fact is, the local monopoly of the Bell operating companies gives them an unfair advantage that no one else has. That in fact is the precise reason why they are kept out of the market, and with that unfair competitive advantage, it would not be unreasonable to expect that they would drive a lot of existing competitors out of the market.

Senator METZENBAUM. Haven't a lot of your members made an enormous investment in new long-distance technology such as fiber?

Mr. HOFFMAN. Absolutely. My company included, there are a number of companies that are in our association, that are in the process of building fiber optic networks which require an enormous investment, not only in land and rights-of-way, and in the facilities, but in the labor to put it in the ground, and the switching.

My company alone, in the past 3 years, has invested over $2 billion, and there are others like MCI, who is not a member of our association, and National Telecommunications Network, and other companies, that are expending a great deal of money on putting fiber into the ground.

Senator METZENBAUM. If the BOC companies were permitted to enter the long-distance field, would your investment in those areas be jeopardized?

Mr. HOFFMAN. Eventually, yes, sir.

Senator METZENBAUM. Are you confident that the Justice Department would vigorously enforce the antitrust laws to prevent the Bell Companies from abusing their monopoly power if they were allowed to enter long-distance?

Mr. HOFFMAN. Well, I am confident that the Department of Justice would vigorously enforce the antitrust laws. The problem is the Federal Government's definition of vigorous sometimes involves 10 years to bring a case to conclusion. And in the fragile state of competition in our industry now, I do not think we could afford another 10-year antitrust case.

Senator METZENBAUM. Mr. Johnson, let me ask you: Ameritech and others have cited the French experience in information services as an example of the benefits that the Bell Companies could provide, if they were able to compete in this area.

Is France's experience a good indication of what would happen in this country if the Bell Companies were allowed in, and if not, why not?

Mr. JOHNSON. Well, first, Mr. Chairman, we have to start with the recognition that the French experience involves a governmentally owned telephone company that is basically subsidizing new equipment into the market in an attempt to develop a market, and furthermore, the real purpose of the French experience is not necessarily to improve telecommunications in France, but it is to be on the "leading edge" so it can export those telecommunications to other countries around the world. The French system is subsidized. It is subsidized by the Federal Government.

The Federal Government basically is putting new computers in the homes, in the place of the basic telephone. But I think there is one message to be learned from the French system, other than the need for subsidization to get a service like this going, and that is that for the French system to work, the French Government, the French telephone company, agreed that it would not get into the information business itself.

Rather, what it did, other than providing the basic directory service, was exclude itself from the information business and encouraged many, many independent suppliers to become information providers to that system.

So, to the extent of a model for how content and conduit should be measured, I would say the French system has something that we can learn from. And on the whole question of subsidizing information services, I doubt very much whether this would ultimately be to the benefit of the ratepayer, and I know that this country does not want to get into State ownership of the telephone system.

Senator METZENBAUM. There have been some rather dramatic failures in the electronic publishing business in this country.

Why have the electronic publishing markets not developed as quickly as had been expected earlier?

Mr. JOHNSON. Well, I think like any new marketing venture, one thing that we all find is that it is very difficult to create a market where it does not exist.

I think the reality is that many of the ventures were out ahead of the consumer. They were out ahead of the consumer in terms of the consumer's needs, and they were out ahead of the consumer, frankly, in terms of the cost.

Now the difference I think in what we are talking about today is in those experiments which have occurred and have failed. In every one of those cases, those were publicly held companies in which the failures, many times in the millions and multi-millions of dollars, were absorbed by the shareholders.

If the BOCs get into this business, and if the BOCs go further because of their ability to control the conduit and exclude others from getting into the business, the question is, is it the shareholders who are going to suffer those loses or are the ratepayers going to subsidize it?

And I would only point to the fact, as this committee has already taken notice of, that in 1985, over $1 billion was lost by the BOCs in new ventures.

So the question is, we already have this experience of the market not rapidly embracing these new services, and who is going to pay for them if they are forced upon the market?

Senator **Metzenbaum**. I want to thank the members of this panel for their assistance, and all of the others who have participated today.

The committee, in all probability, will prepare a report of today's hearing, because I know a number of my colleagues do have a strong interest in the subject, and it is well known that each of them has their own committee hearings this morning, so we probably will move forward to summarize the testimony and indicate our own thoughts on the subject. Thank you.

[Whereupon, at 12:05 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

APPENDIX

Consumer Federation of America

LOCAL RATE INCREASES IN THE POST-DIVESTITURE ERA: EXCESSIVE RETURNS TO TELEPHONE COMPANY CAPITAL

DR. MARK N. COOPER

SEPTEMBER, 1986

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LOCAL RATE INCREASES IN THE POST-DIVESTITURE ERA: EXCESSIVE RETURNS TO TELEPHONE COMPANY CAPITAL

EXECUTIVE SUMMARY

Immediately upon the break-up of AT&T the Regional Bell Operating Companies (RBOCs) asked state public utility commissions (PUCs) for large rate increases. The majority of those requests were based on changes in capital structure and capital costs.

The phone companies argued that they had lost the "financial umbrella" of the huge national monopoly and faced more competition which increased the riskiness of their business. To compensate stockholders and position the companies for the new competitive environment, an increase in the return on equity, an acceleration of depreciation schedules and a reduction in the role of debt in the capital structure were requested by the companies.

Customers of the telephone company resisted these arguments, suggesting that the local monopolies which had been separated from the more competitive long distance services were not subject to greater risk or financial instability.

Two and one-half years have passed since divestiture and well over a year has passed since most companies were granted post-divestiture increases. This report evaluates the extremely favorable treatment granted to the RBOCs in the uncertain and pressure filled atmosphere of divestiture. It finds that stockholders have reaped a windfall of excess profits at the expense of ratepayers.

The current overcharge is on the order of $3 billion including:

excessive returns on equity costing customers between $1.25 and $2 billion per year;

unnecessary accelerations of depreciation costing customers at least $1 billion per year;

unjustified debt expenses costing customers between $.2 and $.4 billion per year.

In the first six months of 1986 the RBOCs had a return on equity that was about 3.5 percentage points higher than other utilities and the largest corporations in the nation. Their rate of profit was about one-third higher than these other companies.

> As regulated companies, this is a truly remarkable and unjustified premium above the average corporation.
>
> Virtually all of the increase in rates above inflation in the past year has taken the form of unjustified increases in real returns to capital.

The recent action by the Federal Communications Commission to lower rates of return on interstate access revenues, which did not go far enough even in the interstate area, leaves the excess revenues of the RBOCs at over $2.5 billion. The bulk of the problem must be addressed at the state level. Elimination of these excess returns to capital would not affect the quality of service, nor would it affect actual operating expenses or levels of employment.

THE PRICE OF TELEPHONE SERVICE: PRE AND POST DIVESTITURE

For half a century, until the early 1980s, real telephone rates for all services declined (see Exhibit ES-1). The driving forces behind this decline was a continuous advance in technology that reduced the costs of telephone service and a continuous expansion of the network that spread fixed costs across ever increasing volumes of traffic.

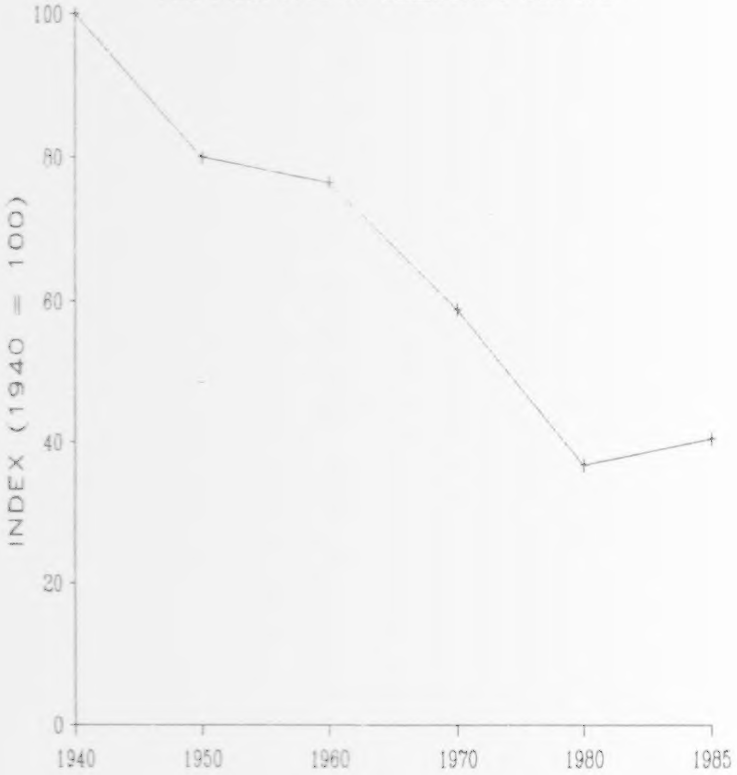
In the early 1980s, the decline in real telephone rates ceased. Rates for local telephone service and rates for overall service for the average user began to rise faster than inflation. Technological progress had not stopped, nor had the expansion of the network ceased. Reversal of the trend was precipitated by policy changes in rate setting at the federal and state levels.

Since 1980 local charges have increased by 80 percent and total phone charges have increased by 50 percent. Over the same period, the general consumer price increase was about 38 percent and the increase in the producer price index was about 20 percent.

Key components of producer price index which would most directly influence telephone company costs have been increasing much less rapidly than telephone rates. Since divestiture, computer costs have fallen by about 20 percent. Metals and metal products are up only 9 percent. Fuel and energy prices increased by only 10 percent until early 1986 and then plummeted. Wage rates in telecommunications have increased by just over 10 percent, but employment in the RBOCs has decreased by 4 percent. These changes in input costs certainly do not indicate that telephone rates should have been increasing faster than inflation.

EXHIBIT ES-1

THE REAL COST OF TELEPHONE SERVICE



SOURCE: CONSUMER PRICE INDEX

The balance sheets of the RBOCs corroborate the conclusion that it is returns to capital that are driving recent rate increases. In 1985 depreciation expenses increased almost 18 percent and net income increased almost eleven percent, but other expenses increased only 8 percent.

THE RETURN ON EQUITY OF THE BABY BELLS

The financial performance of the RBOCs indicates that these increasing returns to telephone company capital are unjustified. Exhibit ES-2 compares the return on equity (ROE) achieved by the RBOCs in 1984 and 1985 to the return on equity of the largest 1000 corporations and non-RBOC utilities.

In 1984, before most of the post divestiture rate cases were completed or could have much of an impact on the RBOC financial performance, the RBOC's ROE was slightly above the non-RBOC utilities ROE and equal to the top 1000.

In 1985, in part reflecting a decline in inflation and certainly a reduction in inflationary expectations, rates of return on equity for the largest 1000 corporation decreased by two percentage points, while the ROE for non-RBOC utilities declined 3.5 percentage points. In sharp contrast, state regulators singled out telephone utilities for special treatment, allowing the RBOC return on equity to increase by half a percentage point.

As a result, the return on equity of the RBOCs in 1985 was 4 percentage points above non-RBOC utilities and 2.3 percentage points above the top 1000. In 1986 the gap was almost 3.5 percent in both cases.

This extremely high rate of return cost ratepayers a great deal of money in 1985. If the RBOC's had a return equal to non-RBOC utilities. return on equity would have cost customers $2.2 billion less. If the RBOCs had a return on equity equal to that of all manufacturing firms, ratepayers bills would have been $1.8 billion lower. If the RBOCs had a rate of return equal to that of the top 1000, customers bills would have been $1.25 billion less.

Reductions of rates by these amounts would not affect the level of service, nor should they affect actual operating expenses of the companies. They would eliminate the gravy that has been granted to stockholders.

EXHIBIT ES-2:
RETURN ON EQUITY: RBOCS COMPARED TO OTHER UTILITIES AND THE LARGEST U.S. CORPORATIONS

COMPANIES	RETURN ON COMMON EQUITY		
	1984	1985	1986
AMERITECH	14.1	14.5	14.7
BELL ATLANTIC	13.1	13.8	14.3
BELL SOUTH	13.4	14.2	14.8
NYNEX	12.9	13.3	14.0
PACTEL	12.8	12.8	13.7
SW BELL	12.9	13.6	12.8
US WEST	13.3	13.3	13.4
RBOC AVERAGE	13.2	13.7	14.1
NON-RBOC UTILITIES	9.8	9.7	10.8
TOP 1000 CORPS.	13.2	11.4	10.6

SOURCE: "Corporate Scoreboards," *Business Week*, 1985 and 1986 Special Issues and August 18, 1986. The 1986 numbers pertain to the performance in the first half of the year and include only 900 corporations. Non-RBOC utilities includes all utilities and telephone companies other than the RBOCs.

MARKET-TO-BOOK RATIOS

A second method for analyzing whether the return on equity is being set fairly is to observe the ratio of the market value of the stock to the book value. The consensus opinion is that for utilities, the market-to-book ratio should be just slightly above one.

Exhibit ES-3 shows that in 1984, before the post-divestiture rate increases had an opportunity to have their full effect, the market-to-book value of the RBOCs was about 1.19. This was somewhat above the all utility market-to-book ratio of 1.14. In 1985, the market-to-book ratio for the RBOCs increased dramatically to an average of 1.44, which is way out of line for a regulated utility.

Underlying a regulated utility market-to-book ratio that is so high are profit margins and stock yields that are extremely high. The RBOCs' profit margin and stock yield are all well above the average for the top 1000 corporation and well above the utility average.

DISCOUNTED CASH FLOW ANALYSIS

A third method for estimating the cost of capital is the discounted cash flow (DCF) method. This approach attempts to directly estimate what investors demand/expect from a stock. A recent DCF analysis conducted by the General Services Administration found that the return on equity, compared to the climate that prevailed at divestiture, should be reduced by 2.6 percentage points.

Whatever method is chosen to derive a fair rate of return on equity, the high ROE earned by the RBOCs cost consumers between $1.25 and $2 billion per year.

DEPRECIATION

Return on equity is referred to as return _on_ capital. It represents the money investors make on their investment. There is also a return _of_ capital to investors. This takes the form of depreciation. When goods or services are produced, capital is used. In its physical form -- machinery, buildings, equipment -- wears out or becomes obsolete and must be replaced.

In the post-divestiture environment, the FCC and the telephone companies argued that the return _of_ capital had to be sped up through acceleration of depreciation schedules. The FCC imposed faster depreciation schedules on the states. Many of the states had refused to accelerate depreciation, arguing that competition was weak and little change had taken place in the underlying technological

EXHIBIT ES-3
MARKET-TO-BOOK VALUE AND OTHER INDICATORS OF FINANCIAL PERFORMANCE

COMPANY	MARKET-TO-BOOK		SALES GROWTH	YIELD		PROFIT MARGIN	
	1984	1985	1985	1984	1985	1984	1985
AMERITECH	1.25	1.57	8	7.3	5.5	11.9	11.9
BELL ATLANTIC	1.19	1.56	12	7.7	5.5	12	12
BELL SOUTH	1.31	1.58	11	7.4	5.4	13.1	13.3
NYNEX	1.13	1.44	8	7.6	5.5	10.4	10.6
PACTEL	1.16	1.33	9	7.1	6.4	10.6	10.9
SW BELL	1.14	1.24	10	7.2	6.6	12.3	12.6
U.S. WEST	1.13	1.33	7	7.6	5.9	12.2	11.8
RBOC AVG.	1.19	1.44	9.34	N/A	N/A	11.8	11.9
ALL UTILITIES	1.15	N/A	5	7.6	N/A	9.5	8.7
TOP 1000	1.5	1.58	5	3.2	2.8	5.2	4.5

SOURCES: BUSINESS WEEK, The Top 1000, 1986 Special and Scoreboard, June 24, 1986
RBOC averages are weighted averages. Market-to-book ratio is defined as stock prices/book value, with assets used as weights. Yield is defined as annual dividends as a percent of market price. Profit margin is defined as profits as a percentage of sales. Revenue is used for weighting. Sales growth is in percent. Revenue is used for weighting.

processes which had typified the industry for half a century. Rapid technological progress had certainly been made under slower, state depreciation schedules.

In June, 1986 the Supreme Court resolved this dispute by agreeing with the states. States are now free to set their own depreciation schedules as they had since the beginning of the industry.

Exhibit ES-4 shows estimates of the cost to customers of accelerated depreciation in 1985 for each of the RBOCs and the RBOCs in aggregate. All of the RBOCs had increases in the depreciation rate. If those increases had not taken place, the revenue requirement would have been about $1 billion per year less.

DEBT

Regulated utilities finance their investments with more than equity capital. They typically use debt to finance a considerable part of their investment. Debt is an attractive financing mechanism because it tends to cost less than equity. Debt obligations are met before equity obligations, therefore they are considered less risky and earn lower returns. Expensive equity should not be allowed to play too large a role in the capital structure.

Historically, equity financing of utility services has been in the range of 45 to 55 percent of total investment but the argument presented at the onset of divestiture -- that the environment was much riskier for the RBOCs -- was also used to request an increase in the role of equity in the capital structure. With the competitive threat proving to be minimal and the turbulence of the divestiture process subsiding, it is time to revisit those decisions.

In order to obtain a general sense of how important the capital structure has been in recent rate increases we obtained data on the capital structure of the telephone company in one of the largest states served by each of the RBOCs. We then calculated the savings to customers if the RBOCs companies were forced to return to the capital structure that was in place prior to divestiture. In the aggregate, the cost savings to customers would be in the range of a quarter of a billion dollars per year.

Not only should the RBOCs rely on less equity and more debt in their capital structure, but it appears that their cost of debt should be reexamined. One of the important factors that has caused a reduction in the nominal return on equity -- the sharp decline in inflation -- has also been operating to lower the nominal cost of debt by three percentage points in the past two years and is still declining. Reductions in the RBOC cost of debt could save customers $100 million per year.

EXHIBIT ES-4
THE IMPACT OF ACCELERATED DEPRECIATION ON THE REVENUE REQUIREMENT
(Millions of Dollars)

COMPANY	DEPRECIATION RATE		DEPRECIABLE ASSETS, 1985	CONSUMER SAVINGS FROM 1984 RATE APPLIED TO 1985 ASSET BASE (Millions of Dollars)
	1984	1985		
AMERITECH	.073	.082	19545	175.91
BELL ATLANTIC	.062	.071	20772	186.95
BELL SOUTH	.066	.072	24993	149.96
NYNEX	.056	.063	22813	159.691
PACTEL	.058	.06	20493	40.99
SW BELL	.062	.066	19875	79.50
U.S. WEST	.062	.067	19496	97.48
RBOC TOTAL	N/A	N/A	147987	890.47

SOURCES: Depreciation rates are from Annual Reports. Ameritech, BellSouth and U.S. West are calaculated in the reports themselves. The other RBOCs have been estimated based on the formula:

Depreciation Rate = Depreciation Expense/ (Assets - Plant Under Construction)

Combining the two components of debt -- the ratio of debt in the capital structure and the cost of debt -- leads us to conclude that a very conservative estimate of ratepayer savings in the range of $200 to $400 million per year could be achieved.

CONCLUSION

The aspects of capital discussed in this report equal about one-third of the revenue generated by the RBOCs. We have shown that each of these components of capital experienced unjustifiable increases in 1985. We believe that the overall reduction due ratepayers is in the range of $3 billion per year. The FCC's recent action reduces the current excess to $2.5 billion.

Excess returns to capital of that magnitude would account for virtually all of the increases in local telephone rates above inflation since divestiture (see Exhibit ES-5). If capital charges are reduced by $3 billion, that would equal a reduction in capital charges of 15 percent. This could translate into a rate reduction of about 5 percent for RBOC customers. Because it affects excess returns to capital, it would not affect the quality of service or other expenses.

It is incumbent on state public utility commissions to rectify this situation immediately. The financial statistics of the RBOCs show beyond a shadow of a doubt that customers are being overcharged.

EXHIBIT ES-5
POST-DIVESTITURE RATE INCREASES COMPARED TO INFLATION
(Millions of Dollars)

COMPANY	TOTAL REVENUE 1984	TOTAL REVENUE 1985	1985 INCREASE ACTUAL	1985 REVENUE REQUIRED TO KEEP UP WITH INFLATION	INCREASE ABOVE INFLATION
AMERITECH	8347	9021	674	8647	374
BELL ATLANTIC	8090	9084	994	8381	703
BELL SOUTH	9631	10664	1033	9978	686
NYNEX	9573	10314	741	9918	396
PACTEL	7824	8499	675	8106	393
SW BELL	7191	7925	734	7450	475
U.S. WEST	7280	7813	533	7542	271
RBOC TOTAL	57936	63320	5384	60022	3298

SOURCES: ANNUAL REPORTS. Inflation is set at 3.6 percent.

I. INTRODUCTION

Immediately upon the break-up of AT&T the regional phone companies asked public utility commissions (PUCs) for large rate increases.1/ The majority of those requests were based on changes in capital structure and capital costs.

The phone companies argued that they had lost the "financial umbrella" of the huge national monopoly and they now faced more competition. They argued that both factors increased the riskiness of their business and, therefore, their stockholders should be rewarded for bearing that greater business risk. To compensate stockholders and position the companies for the new competitive environment, an increase in the return on equity, an acceleration of depreciation schedules and a reduction in the role of debt in the capital structure were requested by the companies.2/

Customers of the telephone company, through their intervenors, resisted these changes, arguing that the local monopolies which had been separated from the competitive long distance services were not subject to greater risk or financial instability. As the author of this report testified in one of the first post-divestiture rate cases:

> Let us not forget that the value of the telephone system resides in the local network...
>
> There is no need to grant one penny of rate increase or rate restructuring in the name of bypass and competition until bypass and competition prove themselves in the reality of the marketplace.3/

Under immense pressures from phone companies and in an environment of uncertainty, it was difficult for (PUCs) to resist the arguments of the phone companies. More than half of the record breaking rate requests were granted.4/

Two and one-half years have passed since divestiture and well over a year has passed since most companies were granted post-divestiture increases. The record now shows that those who argued against increasing the returns to telephone company stockholders were correct. The competitive threat to the local phone companies has been miniscule. The local monopoly remains firmly entrenched and stockholders have reaped a windfall of excess returns at the expense of ratepayers.

The excessive returns allowed the telephone company have become so blatant that even agencies of the federal government have begun to complain.5/ The observation made by some commentators that requests for rate increases have moderated in recent months misses the fundamental point that,6/ when one examines the financial performance of the telephone companies, rates are too high and should be reduced.

PURPOSE AND CONCLUSIONS OF THE REPORT

This report documents the nature and extent of the current overcharging for telephone services that ratepayers suffer at the local level. It presents aggregate, order of magnitude estimates across the Regional Bell Operating Companies (RBOCs) looking at both state level data and RBOC level data.

Obviously, the changes necessary to restore the balance between telephone ratepayers and stockholders must take place on a state-by-state basis. By presenting aggregate and summary measures of the magnitude of current overcharges, the goal of this report is to give urgency to the need for quick and vigorous action by state PUCs to address the problem.

Based on 1985 financial data, we estimate that customers are being overcharged billions dollars by local phone companies. This overcharge is composed of:

> excessive returns on equity costing customers between $1.5 and $2 billion per year;
>
> unnecessary accelerations of depreciation costing customers over $1 billion per year;
>
> unjustified debt expenses costing customers between $.2 and $.4 billion per year.

In summary, at least $2.5 billion and perhaps as much as $3.5 billion in recent revenue increases granted to the RBOCs have been unjustified.

> Virtually all of the increase in rates above inflation in the past two years has taken the form of unjustified increases in real returns to capital.

In the first six months of 1986 the RBOCs had a return on equity that was about 3.5 percentage points higher than other utilities and the largest corporation in the nation. Their rate of profit was about one-third higher than these other companies. As regulated companies, this is a truly remarkable premium above the average corporation.

The recent action by the FCC to lower rates of return on interstate access revenues, which did not go far enough even in the interstate area, leaves the excess revenues of the RBOCs at over $2.5 billion.

These conclusions are based on financial data through the end of 1985. Mid-year 1986 reports only reinforce the basic conclusion -- local rates are too high because telephone company capital has been treated much too generously by PUCs.7/ A $3 billion reduction in returns of an on capital would be equal to about a 15 percent reduction in the overall return to capital and a 5 percent reduction in local rates.

Such reductions would not affect service or operating expenses. They would eliminate unnecessary returns to capital.

Moreover, there should be no mistake about the fact that the regulated monopolies are the core of the business of the RBOCs that is generating this extremely high profitability. For the RBOCs as a whole, approximately 90 percent of their revenues come from their traditional, monopoly business -- local service and network access charges.8/

The uncertainty of the break up of AT&T has been resolved. The local phone companies remain a secure local monopoly. The threat of competition and the potential increase in risk hypothesized by local phone companies in their first post-divestiture rate cases have not materialized. The concessions granted to protect the phone companies from these threats -- greater returns to capital -- have proven to be unjustified. PUCs should immediately revisit and reverse the fundamental decisions made in the immediate aftermath of divestiture which are costing ratepayers billions of dollars per year.

The urgency in addressing this problem stems not only from the magnitude of the overcharges, but also from the ever-changing structure of the industry. One of the primary methods for franchise monopolies earning excessive returns to capital to hide those excesses is to diversify. These companies use the excess returns to create a more diversified parent company. Because the subsidiary companies are not individually traded on the stock market, the regulated entities claim that the strong financial performance of the diversified parent holding company is due to the unregulated lines of business. The truth is that the monopoly business is and will remain the truly profitable entity9/ but the excessive profitability is hidden behind the ambiguities of holding company accounting.10/

A campaign to diversify has been launched by the RBOCs in the marketplace and in political efforts to end restrictions placed on them in the Bell break-up. This makes it even more important for state PUCs to act quickly so that revenues obtained by overcharging customers of the regulated RBOC services are not used to finance RBOC expansion into competitive markets.

OUTLINE OF THE REPORT

Chapter II of the report examines the causes of recent rate increases, showing that they have resulted from increases in capital costs, not operating costs.

Chapter III establishes the conceptual framework for evaluating whether these increases in capital costs are justified by defining the cost of capital and a "fair" rate of return.

Chapter IV demonstrates that the return on equity achieved by the RBOCs is much too high. It applies three different methods -- comparative earnings, market-to-book ratios, and discounted cash flow analysis -- all of which lead to the same conclusion.

Chapter V examines the impact of other costs associated with capital on telephone bills. First, it assesses the impact on customers of the acceleration of the depreciation rate which was imposed on the states by the FCC. Second, it assesses the impact of changing capital structure (debt/equity ratios) and debt costs on customers.

Chapter VI summarizes the findings.

II. THE PRICE OF TELEPHONE SERVICE: PRE AND POST DIVESTITURE

THE END OF AN ECONOMIC ERA OR A MISTAKEN POLICY

At the outset, the historical context of telephone rates should be considered. For half a century, until the early 1980s, real telephone rates for all services declined (see Exhibit II-1).1/ The driving forces behind this decline was a continuous advance in technology that reduced the costs of telephone service and a continuous expansion of the network that spread fixed costs across ever increasing volumes of traffic.2/

In the early 1980s, the decline in real telephone rates ceased. Rates for local telephone service and rates for overall service for the average user began to rise faster than inflation. Technological progress had not stopped, nor had the expansion of the network ceased.3/ Reversal of the trend was precipitated by policy changes in rate setting at the federal and state levels.

EMPIRICAL EVIDENCE ON THE CAUSES OF RISING RATES

NETWORK EXPANSION

Observation of the operating characteristics and costs of the telephone company compared to other costs in the economy demonstrates that policy and organizational changes have reversed the trend of prices in the telecommunications industry.

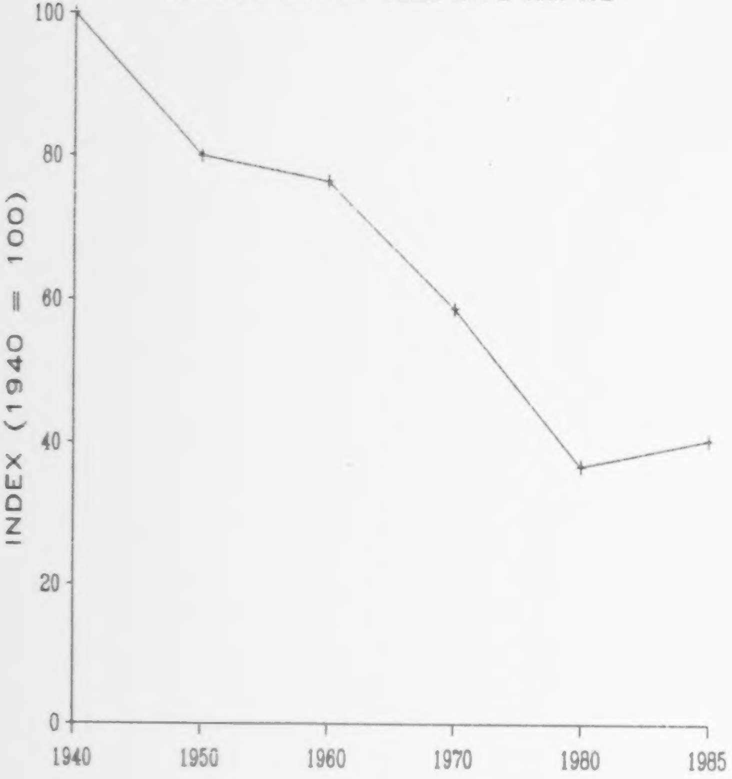
Exhibit II-2 shows that after divestiture the RBOCs enjoyed growth in both the number of access lines and the number of intraLATA toll messages. Competition and bypass of the network did not steal enough business to reverse the trend of continuous expansion of the network.3/

Competition for the local phone company in the form of bypass of the network was a central concern of many of the first post-divestiture rate cases.4/ Bypass occurs when a customer -- generally a large volume user -- finds an alternative to the local switched network and thereby denies his business to the local company.

A great deal of theoretical and hypothetical work was done prior to and immediately after divestiture about the threat of bypass.5/ The empirical evidence of actual bypass was always sparse. Most actual bypassers were more concerned about acquiring qualities of service that the local network could not provide than about price. In addition, most potential bypassers

EXHIBIT II-1

THE REAL COST OF TELEPHONE SERVICE



SOURCE: CONSUMER PRICE INDEX

EXHIBIT II-2:
INDICATORS OF NETWORK EXPANSION: 1984-1985
(Millions)

RBOC	ITEM	1984	1985	PERCENT INCREASE 1984-1985
AMERITECH				
	ACCESS LINES	14.3	14.6	2.1
	TOLL MESSAGES	N/A	N/A	N/A
BELL ATLANTIC				
	ACCESS LINES	14.7	15.1	2.7
	TOLL MESSAGES	1913	1970	3.0
BELL SOUTH				
	ACCESS LINES	14	14.5	3.6
	TOLL MESSAGES	1073	1204	12.2
NYNEX				
	ACCESS LINES	13.2	13.6	3.0
	TOLL MESSAGES	N/A	N/A	N/A
PACTEL				
	ACCESS LINES	11.3	11.7	3.5
	TOLL MESSAGES	1994	2168	8.7
SW BELL				
	ACCESS LINES	10.7	10.9	1.9
	TOLL MESSAGES	847	901	6.4
U.S. WEST				
	ACCESS LINES	10.9	11.2	2.8
	TOLL MESSAGES	1341	1391	3.7
ALL RBOCs				
	ACCESS LINES	89.1	91.6	2.8
	TOLL HEASSAGES	7168	7634	6.5

SOURCES: ANNUAL REPORTS AND 10-K FORMS. For companies which report intralata toll and WATS the sum has been included to achieve consistency with companies that report only toll messages. The definition may not be consistent across companies. There is no doubt that growth has been in the range of 6 to 8 percent.

would still purchase a large portion of their communications services from the local phone companies.6/ Even potential revenue losses proved to be small upon close examination, and actual revenue losses were even smaller.7/ Marketing responses by the local companies also further limited bypass.

The RBOCs continue to talk of bypass, but the operating statistics from the first two years show that there has been continued growth in basic local services.8/

COST INCREASES

Costs in industries closely related to telecommunications -- particularly computers -- have continued to decline.9/ Other general costs have risen much more slowly than telephone prices.10/

Since 1980 local charges have increased by 80 percent and total phone charges have increased by 50 percent.11/ Over the same period, the general consumer price increase was about 38 percent and the increase in the producer price index was about 20 percent.12/

Key components of producer price index which would most directly influence telephone company costs have been increasing much less rapidly. Since divestiture, computer costs have fallen by about 20 percent.13/ Metals and metal products are up only 9 percent.14/ Fuel and energy prices increased by only 10 percent until early 1986 and then plummeted.15/ Wage rates in telecommunications have increased by just over 10 percent, but employment in the RBOCs has decreased by 4 percent, yielding a very small increase in labor costs.16/ These changes in input costs certainly do not indicate that telephone rates should have been increasing faster than inflation.

The balance sheets of the RBOCs corroborate the conclusion that it is not operating expenses that have caused the recent rate increases. Exhibit II-3 shows that non-capital expenses (other oper. exp.) have increase more slowly than revenue. In contrast, depreciation charges increased about twice as fast as revenue. Net income increased about 1.2 times as fast as revenue.

The telephone companies argue that this shift in the balance between ratepayers and stockholders toward a more favorable treatment of stockholders was a necessary and inevitable part of the change in the economic environment of the phone companies. The next two chapters show that there was nothing inevitable, necessary or justified in the increase in stockholder rewards. By virtually every measure of reasonableness, the return on

EXHIBIT II-3:
REVENUES AND MAJOR EXPENSES OF THE RBOCS
(Millions of Dollars)

RBOC	ITEM	1984	1985	PERCENT INCREASE 1984-1985
AMERITECH				
	REVENUE	8347	9021	8.1
	DEPRECIATION	1347	1603	19.0
	NET INCOME	991	1078	8.8
	OTHER OPER. EXP.	4849	5129	5.8
BELL ATLANTIC				
	REVENUE	8090	9084	12.3
	DEPRECIATION	1194	1484	24.3
	NET INCOME	973	1093	12.3
	OTHER OPER. EXP.	4340	4793	10.4
BELL SOUTH				
	REVENUE	9631	10664	10.7
	DEPRECIATION	1536	1802	17.3
	NET INCOME	1257	1418	12.8
	OTHER OPER. EXP.	5230	5696	8.9
NYNEX				
	REVENUE	9573	10314	7.7
	DEPRECIATION	1202	1433	19.2
	NET INCOME	986	1095	11.1
	OTHER OTHER. EXP.	6303	6571	4.2
PACTEL				
	REVENUE	7824	8499	8.6
	DEPRECIATION	1084	1238	14.2
	NET INCOME	829	929	12.1
	OTHER OPER. EXP.	4766	5007	5.1
SW BELL				
	REVENUE	7191	7925	10.2
	DEPRECIATION	1141	1302	14.1
	NET INCOME	883	996	12.8
	OTHER OTHER EXP.	4113	4500	9.4
U.S. WEST				
	REVENUE	7280	7813	7.3
	DEPRECIATION	1106	1276	15.4
	NET INCOME	887	927	4.5
	OTHER OPER. EXP.	4279	4544	6.2
ALL RBOCs				
	REVENUE	57936	63320	9.3
	DEPRECIATION	8610	10138	17.7
	NET INCOME	6806	7536	10.7
	OTHER OPER. EXP.	33880	36240	7.0

SOURCES: ANNUAL REPORTS. Other Oper. Exp. is operating expenses minus depreciation and amortization.

equity being enjoyed by the RBOCs is far too high for an industry which retains a firmly entrenched franchise monopoly on services.

III. THE COST OF CAPITAL

INTRODUCTION

We have attributed the recent increase in rates above inflation to capital costs. In order to ascertain whether these increases are justified, we must start from an understanding of what a "fair" cost of capital would be for stockholders and ratepayers.

From the ratepayer point of view, capital imposes three sets of costs -- return on equity, interest on debt, and depreciation. Stockholders are mostly concerned with return on equity and depreciation, since these two involve their capital. Debt is the major concern of bondholders.

All three of these components of capital have received considerable attention in recent months, with the argument being made that each is imposing excessive costs on customers. This chapter will review the conceptualization of a fair return on equity. It lays the ground work for the argument in the next chapter that the return on equity being earned by the telephone companies is far too high.

CONCEPTUALIZING A FAIR RATE OF RETURN

As regulated entities, local telephone companies are entitled to earn a just and reasonable return on the capital which stockholders invest in the company.1/ There is considerable debate over how PUCs should determine the just and reasonable return on equity to allow.

Most financial analysts argue that the return on equity should be set equal to the cost of capital.2/ The cost of capital can be defined as "the expected rate of return prevailing in capital markets on alternative investments of equivalent risk."3/

In economic theory, allowing utilities to earn their cost of capital, but no more, has several benefits. It enables the company to attract capital and make investments but does not force customers to pay excessive rates. It allocates resources efficiently. By inducing investments up to the level at which they are earning returns equal to those available on alternative potential uses involving similar risk, resources are directed into the most efficient uses.4/

EQUIVALENT RISK, RISK PREMIUMS AND REAL RETURNS

Although the concept is straightforward, determining the rate of return on investments of equivalent risk is a difficult empirical matter. Of utmost importance is the fact that the cost of capital is a relative concept. If all companies in the economy are doing poorly, due to a recession for example, then the cost of capital will be lower, since investors will earn relatively small returns on investments of equivalent risk. Similarly, investments of higher risk may earn more, but they are not relevant. The key is determining which investments are of equivalent risk and what they are earning.

The return on risk free investments is relatively easy to determine. Generally, the interest on short term treasury bills is taken to be the risk free return, since there is little likelihood that the federal government will default on its debts in any three or six month period.

How much of a risk premium is required to invest in a private company varies from company-to-company and will be affected by many factors. When the RBOCs entered their first rate proceedings after divestiture, they uniformly argued that their separation from AT&T had increased the financial risk that stockholders faced and that the increasingly competitive environment presented stockholders with greater business risk. What the point of comparison should be remains a subject of debate.

Choosing a point of comparison for investments of equivalent risk is only one of the problems associated with determining a fair rate of return. A second problem arises because the return on equity should be considered in real terms. When the nominal return on equity is set, it includes an inflation component. Investors demand, and are truly only interested in, a real rate of return above inflation. Projecting inflation and adjusting rates of return for inflation has been a difficult and important part of the regulatory process.5/

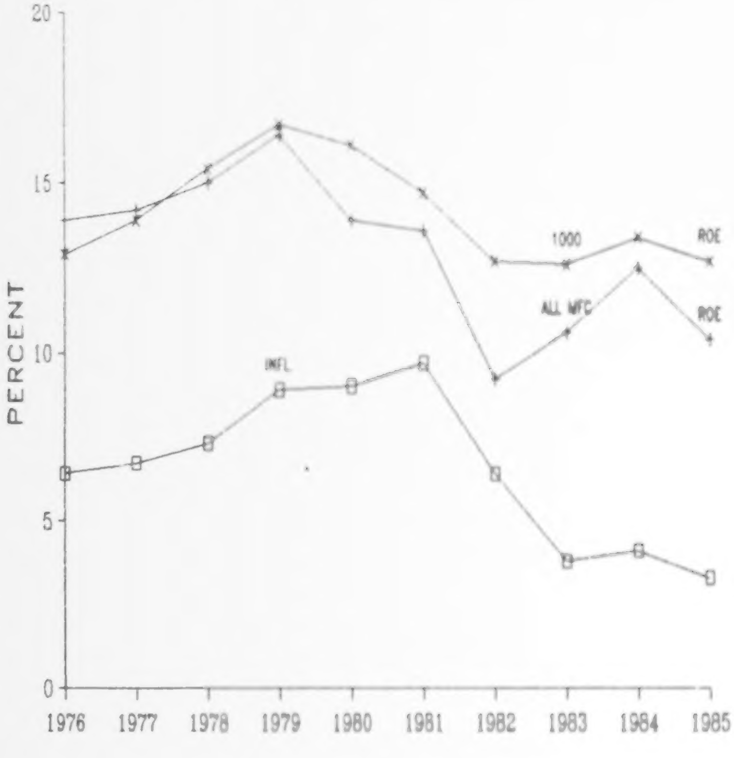
EMPIRICAL EVIDENCE ON THE RELATIONSHIP BETWEEN INFLATION, RETURN ON EQUITY AND THE RISK PREMIUM

Exhibit III-1 shows a comparison between the return on equity for all manufacturing companies and for the largest 1000 companies compared to the rate of inflation. In general, returns track inflation, although the relationship is not perfect.

In other words, the real rate of return has remained relatively constant. For the *Forbes* 1000, the real rate of

FIGURE III-1

RETURN ON EQUITY COMPARED TO INFLATION



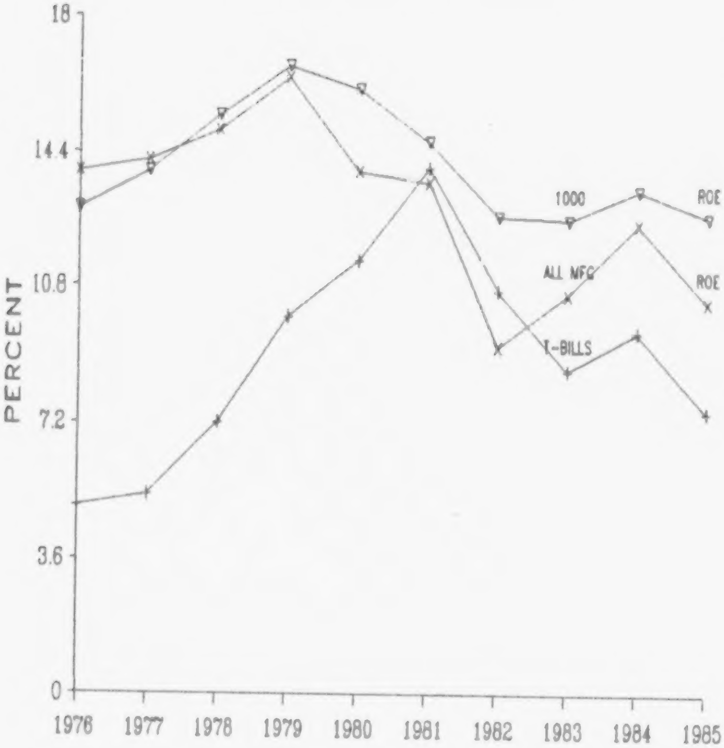
SOURCES: TOP 1000, FORBES ANNUAL SURVEY OF AMERICAN INDUSTRY. ALL MANUFACTURING AND INFLATION, COUNCIL OF ECONOMIC ADVISORS, ECONOMIC REPORT OF THE PRESIDENT, TABLES B-88 AND B-3.

return on equity has fallen in a narrow range from 6 to 9 percent over the past decade. Returns to all manufacturing varied somewhat more, primarily because of very low rates of return during the deep recession of 1982/83.

Similarly, the risk premium which is embodied in the real rate of return has been fairly constant over the past decade. Exhibit III-2 shows the return on equity compared to the 3-month T-bill rate. The real risk premium can be calculated by subtracting the T-bill rate from the ROE. In general, in the past decade the risk premium for the largest 1000 corporations has been about 6 percent. Over longer periods of time the risk premium for larger corporations has been about 8 percent.6/

FIGURE III-2

ROE COMPARED TO T-BILLS



SOURCES: TOP 1000, FORBES ANNUAL SURVEY OF AMERICAN INDUSTRY. ALL MANUFACTURING AND T-BILLS, COUNCIL OF ECONOMIC ADVISORS, ECONOMIC REPORT OF THE PRESIDENT, TABLES B-88 AND B-68.

IV. THE RETURN ON EQUITY OF THE BABY BELLS

INTRODUCTION

The need to recognize the importance of the underlying rate of inflation and to assess the nature of risk in the investment are central to the current debate over the rate of return that the RBOCs are earning. As a recent filing of the General Services Administration argued, PUCs have not incorporated the recent sharp declines in inflation or the lack of serious competition in local service markets into their calculations of the fair rate of return allowed for local phone companies.

> During the last round of rate cases during the past several years when public utility commissions and Bell Operating Companies were setting rates for the initial post-divestiture environment, the major factors considered by Commissions included the high rate of inflation, high costs of money and the uncertain investment risks associated with the divestiture of American Telephone and Telegraph Company and the Bell system. Since this initial round of divestiture rate cases there has been a dramatic decrease in the cost of debt and equity capital and an elimination of the investment risk associated with the breakup of the Bell System into seven Regional Holding Companies and AT&T. These facts have caused the Bell Operating Companies' cost of equity capital to decrease significantly from their 1983-1984 level.1/

Anyone who has had a money market fund in the past few years can well realize the importance of inflation. Everyone would like to have locked in the inflation-bloated interest rates that were being paid in 1981/82. The fifteen percent paid back then would yield a real return of twelve percent today -- a very tidy return indeed. There are telephone companies today whose last rate case was in 1982 and whose allowed rate of return still reflects the inflation-bloated interest rates of the early 1980s.2/

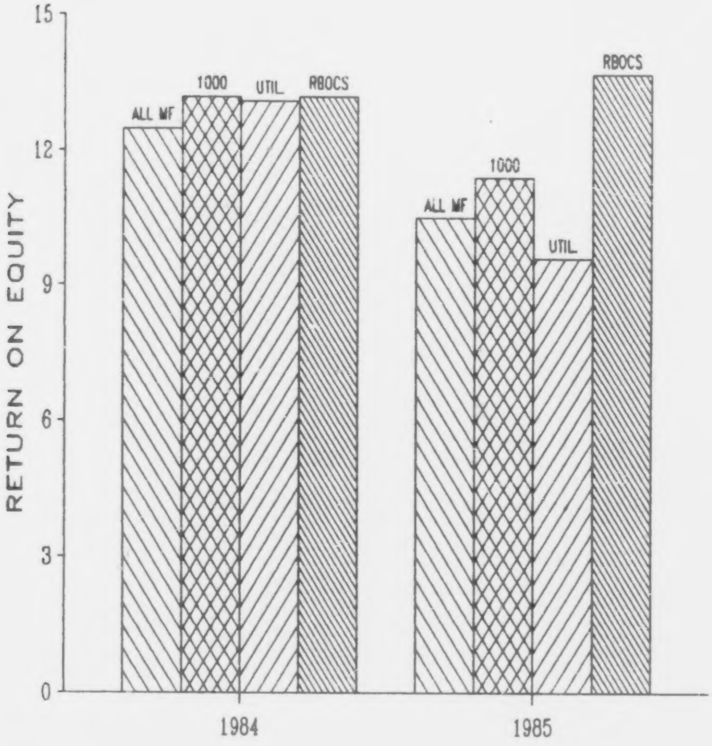
RETURN ON EQUITY

Exhibit IV-1 compares the return on equity achieved by the RBOCs in 1984 and 1985 to the return on equity of all manufacturing companies, the largest 1000 corporations and non-RBOC utilities.

In 1984, before most of the post divestiture rate cases were

EXHIBIT IV-1

RETURN ON EQUITY: RBOCS COMPARED TO OTHER CORPORATIONS



SOURCES: TOP 1000, UTILITIES AND RBOCS, BUSINESS WEEK, THE TOP 1000, SPECIAL ISSUE. ALL MANUFACTURING COUNCIL OF ECONOMIC ADVISORS, ECONOMIC REPORT OF THE PRESIDENT, TABLE B-88 completed or could have much of an impact on the RBOCs' financial performance,3/ the RBOCs were slightly above the non-RBOC utilities and equal to the top 1000. They were well above the average for all manufacturing firms.

In 1985, in part reflecting a decline in inflation and certainly a reduction in inflationary expectations, rates of return on equity for all manufacturing corporations, the top 1000 and non-RBOC utilities declined markedly. In sharp contrast, the RBOC return on equity increased by half a percentage point. For manufacturing firms and the top 1000 the decline was about two percentage points. For the non-RBOC utilities the decline was 3.5 percentage points. Apparently, state regulators believed ti was necessary to treat telephone utilities differently from all other utilities.

The result of this divergence between the RBOC return on equity and the returns for other corporations was to leave the RBOCs with an extremely high rate of return compared to other corporations. The RBOCs were four percentage points above non-RBOC utilities, 3.3 percentage points above all manufacturing firms, and 2.3 percentage points above the top 1000.

The first half of 1986 shows that the RBOCs continued to earn much more than other utilities and the largest corportations in the country (see Exhibit IV-2). The RBOC return on equity grew to 14.1 percent, while the performance of the top corporations slumped to 10.6 percent. The performance of the non-RBOC utilties improved to 10.8 percent, but still was far below that of the RBOCs.

In the first six months of 1986 the RBOCs had a return on equity that was about 3.5 percentage points higher than these comparison groups. Their rate of profit was about one-third higher than other utilities or the largest corporations in the nation. As regulated companies, this is a truly remarkable and unjustified premium above the average corporation.

THE COST TO CONSUMERS OF AN EXCESSIVE RATE OF RETURN

This extremely high rate of return cost customers a great deal of money in 1985 (see Exhibit IV-3). If the RBOCs had a return equal to non-RBOC utilities and all other expenses were held constant, the return on equity portion of the cost of capital would have cost ratepayers $2.2 billion less. If the RBOCs had a return on equity equal to that of all manufacturing firms, customers' bills would have been $1.8 billion lower. If the RBOCs had a rate of return equal to that of the top 1000, customers would have paid $1.25 billion less.

EXHIBIT IV-2:
RETURN ON EQUITY: RBOCS COMPARED TO OTHER UTILITIES
AND THE LARGEST U.S. CORPORATIONS

COMPANIES	RETURN ON COMMON EQUITY		
	1984	1985	1986
AMERITECH	14.1	14.5	14.7
BELL ATLANTIC	13.1	13.8	14.3
BELL SOUTH	13.4	14.2	14.8
NYNEX	12.9	13.3	14.0
PACTEL	12.8	12.8	13.7
SW BELL	12.9	13.6	12.8
US WEST	13.3	13.3	13.4
RBOC AVERAGE	13.2	13.7	14.1
NON-RBOC UTILITIES	9.8	9.7	10.8
TOP 1000 CORPS.	13.2	11.4	10.6

SOURCE: "Corporate Scoreboards," *Business Week*, 1985 and 1986 Special Issues and August 18, 1986. The 1986 numbers pertain to the performance in the first half of the year and include only 900 corporations. Non-RBOC utilities includes all utilities and telephone companies other than the RBOCs.

EXHIBIT IV-3:
CUSTOMER SAVINGS FROM REDUCED RBOC RETURN ON EQUITY

	RATE OF RETURN ON EQUITY (Percent)	BILLIONS OF DOLLARS	
		RETURN ON EQUITY	CONSUMER SAVINGS
ACTUAL	13.7	7.53	N/A
IF RBOCS HAD RETURNS ON EQUITY EQUAL TO:			
NON-RBOC UTILITIES	9.7	5.34	2.19
ALL MFCT.	10.4	5.72	1.81
TOP 1000 CORPORATIONS	11.4	6.28	1.25

Any one of these estimates is a large sum of money but the question remains, to whom should the RBOCs be compared. RBOCs would certainly appear to be less risky than either the typical manufacturing firm or the top 1000.4/ They possess a significant degree of monopoly power -- much greater than the average manufacturing firm or large corporation.5/ Therefore, they are subject to much less business risk. They are very large, all of them ranking around the top 50 in size.6/ Therefore, they would appear to face less financial risk. One could argue that they certainly should have lower returns than the top 1000 or all manufacturing firms.

Are they more risky than other utilities, which also are franchise monopolies? The RBOCs would argue that they face more competition than the other utilities, but that is not so clearly the case.7/

Electric utilities, the largest group of companies among the non-RBOC utilities, face burner tip competition from natural gas utilities in several of the most common and important end-uses -- heating, cooking, and hot water and potential bypass of the system by industrial cogeneration.8/ Natural gas utilities, the second largest group of companies among the non-RBOC utilities, not only face competition from electricity as noted above, they also face competition from oil and coal in industrial boiler uses.9/

In fact, none of these franchised monopolies -- electricity, natural gas, local phone service -- face a great deal of competition. All of them have strong natural monopolies for a large part of their business. Unfortunately, state regulators have failed to carefully compare telephone companies to the other utilitites they regulate in rate proceedings. Based on this analysis, we would conclude that the reduction in ROE should be closer to the upper limit of the range discussed above -- three to four percentage points.

MARKET-TO-BOOK RATIOS

The comparative earnings approach to estimating fair return on equity applied above, has a great deal of intuitive appeal, but it is subject to criticism. Choice of comparison firms is open to debate, and book earnings may not reflect true earnings.10/

A second method for analyzing whether the return on equity is being set fairly is to observe the ratio of the market value of the stock to the book value. Financial analysts compare the selling price of the stock to the value of its assets as they are carried for accounting purposes.

The consensus opinion is that for utilities, the market-to-book value should be just slightly above one -- the market should value the firm just slightly above its book value.11/ When the market-to-book value equals one, the rate of return allowed will be equal to the cost of capital.

Exhibit IV-4 shows the market-to-book value of the RBOCs in 1984 and 1985. We observe that in 1984, before the post-divestiture rate increases had an opportunity to take full effect, the market-to-book value of the RBOCs was about 1.19. This was somewhat above the all utility market-to-book ratio of 1.14. In 1985, the market-to-book ratio for the RBOCs increased dramatically. In 1985, the RBOC market-to-book ratio averaged 1.44.

It can be argued that 1.19 is too high for a regulated utility, although some believe it is justified. Usually the debate before public service commissions centers on a range of 1.05 to 1.10. There is absolutely no doubt that a market-to-book ratio for a regulated utility of 1.44 is way out of line.

Underlying a regulated utility's market-to-book ratio that is so high are profit margins and stock yields that are extremely high. These are all well above the average for the top 1000 corporations and well above the utility average.

DISCOUNTED CASH FLOW ANALYSIS

The market-to-book ratio approach to ascertaining whether the return on equity is fair is also subject to criticism. Above all, it can be circular.12/ Markets evaluate stocks of regulated utilities based, in significant measure, on what they expect regulators to do. How can regulators then act according to how markets evaluate stocks? Regulators would be responding to what markets expect regulators to do.

A third method for estimating the cost of capital is the discounted cash flow (DCF) method. This approach attempts to estimate what investors demand/expect from a stock. The DCF model defines the cost of capital as the sum of expected dividend yield and the expected growth rate of dividends.13/

Neither of these quantities is beyond debate. They require estimation by reference to actual performance and stated expectations of analysts. We will not go into those matters in this report. However, a recent analysis conducted by the General Services Administration provides a set of DCF analyses.14/

Exhibit IV-5 shows the results of the DCF analysis conducted

EXHIBIT IV-4
MARKET-TO-BOOK VALUE AND OTHER INDICATORS OF FINANCIAL PERFORMANCE

COMPANY	MARKET-TO-BOOK		SALES GROWTH	YIELD		PROFIT MARGIN	
	1984	1985	1985	1984	1985	1984	1985
AMERITECH	1.25	1.57	8	7.3	5.5	11.9	11.9
BELL ATLANTIC	1.19	1.56	12	7.7	5.5	12	12
BELL SOUTH	1.31	1.58	11	7.4	5.4	13.1	13.3
NYNEX	1.13	1.44	8	7.6	5.5	10.4	10.6
PACTEL	1.16	1.33	9	7.1	6.4	10.6	10.9
SW BELL	1.14	1.24	10	7.2	6.6	12.3	12.6
U.S. WEST	1.13	1.33	7	7.6	5.9	12.2	11.8
RBOC AVG.	1.19	1.44	9.34	N/A	N/A	11.8	11.9
ALL UTILITIES	1.15	N/A	5	7.6	N/A	9.5	8.7
TOP 1000	1.5	1.58	5	3.2	2.8	5.2	4.5

SOURCES: BUSINESS WEEK, "The Top 1000," 1986 Special and "Scoreboard," June 24, 1986.
RBOC averages are weighted averages. Market-to-book ratio is defined as stock prices/book value, with assets used as weights. Yield is defined as annual dividends as a percent of market price. Profit margin is defined as profits as a percentage of sales. Revenue is used for weighting. Sales growth is in percent. Revenue is used for weighting.

EXHIBIT IV-5
THE DISCOUNTED CASH FLOW (DCF) ANALYSIS PRESENTED BY
THE GENERAL SERVICES ADMINISTRATION

RBOC		AT DIVESTITURE	1985	1988-1989
AMERITECH				
	DIV YLD	9.5	5.9	5.9
	GROWTH	5	5.8	5.5
	DCF"	14.5	11.7	11.4
BELL ATLANTIC				
	DIV YLD	9.9	5.8	5.8
	GROWTH	4.7	5.3	5.4
	DCF"	14.6	11.1	11.2
BELL SOUTH				
	DIV YLD	8.7	5.8	5.8
	GROWTH	4.7	6.9	5.4
	DCF"	13.4	12.7	11.2
NYNEX				
	DIV YLD	9.8	5.9	5.9
	GROWTH	4.1	5.4	6.3
	DCF"	13.9	11.3	12.2
PACTEL				
	DIV YLD	9.8	6.4	6.4
	GROWTH	4.3	5.3	5.1
	DCF"	14.1	11.7	11.5
SW BELL				
	DIV YLD	10.2	6.8	6.8
	GROWTH	4.5	4.8	5.6
	DCF"	14.7	11.6	12.4
U.S. WEST				
	DIV YLD	9.6	6.3	6.3
	GROWTH	5.5	5.6	5.8
	DCF"	15.1	11.9	12.1
AVERAGE "DCF"		14.3	11.7	11.7

SOURCE: SOURCE: Langsam, M. Analysis and Affidavit of the Department of Defense, General Services Administration and All Other Federal Executive Agencies of the United States for an Investigation April 23, 1986. Dividend Yield is defined in Table IV-3. Growth is in percent.

by GSA. Across all the RBOCs it shows that the return on equity, compared to the climate that prevailed at divestiture, should be reduced by 2.6 percentage points. This is within the range of the reduction in return on equity which was suggested by the comparative earnings method above.

CONCLUSION

The three methods of estimating the reasonableness of the return on equity discussed in this section are certainly the most frequently used in the regulatory arena. Although each can be criticized, taken together they present a convincing case that the return on equity of the RBOCs is much too high.

Exhibit IV-6 shows the authorized rate of return as of late 1985/early 1986 for 46 states. The authorized rates of return are far above a reasonable rate of return as estimated by each of the methods. A reduction in the range of 2.5 to 3.5 percentage points is certainly in order. Such a reduction would reduce ratepayer prices by $1.5 to $2 billion.

The recent action by the FCC to lower rates of return on interstate access revenues, which fell far short of a sufficient reduction, leaves the excess revenues of the RBOCs approximately $2.5 billion.

EXHIBIT IV-6
AUTHORIZED RETURN ON EQUITY
(Percent)

STATE	AUTHORIZED RETURN ON EQUITY
ARIZONA	14.25
ARKANSAS	13.50
CALIFORNIA	16.00
COLORADO	14.80
DELAWARE	15.00
WASHINGTON, D.C.	15.10
FLORIDA	15.00
GEORGIA	15.00
IDAHO	14.00
ILLINOIS	15.85
INDIANA	15.50*
IOWA	13.76
KANSAS	14.50
KENTUCKY	14.00
LOUISIANA	14.75
MAINE	15.00
MARYLAND	14.60
MASSACHUSETTS	15.00
MICHIGAN	13.80
MINNESOTA	14.50
MISSISSIPPI	14.45
MISSOURI	14.70
MONTANA	13.50*
NEBRASKA	14.10
NEVADA	14.60
NEW JERSEY	15.50
NEW MEXICO	14.25
NEW YORK	14.00
N. CAROLINA	15.00
N. DAKOTA	14.00
OHIO	14.08*
OKLAHOMA	14.25
OREGON	13.20
PENNSYLVANIA	15.15
S. CAROLINA	15.00
S. DAKOTA	13.30*
TENNESSEE	14.50
TEXAS	14.50
UTAH	14.75*
VIRGINIA	15.00
WASHINGTON	14.70*
WISCONSIN	14.25
W. VIRGINIA	13.50
WYOMING	14.00

SOURCES: LANGSAM, FORM 10-K ANNUAL REPORTS, MINNEAPOLIS STAR AND TRIBUNE.

A * indicates that there are discrepancies between the sources in the reported return on equity. Where discrepancies exist, Minneappolis Star and Tribune report is used, since it is the most recent.

V. OTHER CAPITAL CHARGES

INTRODUCTION

Although return on equity receives the lion's share of attention in regulatory proceedings, there are other costs to consumers associated with capital. Depreciation expenses and debt costs were also altered in the wake of divestiture to unnecessarily increase customer bills.

DEPRECIATION

THE CONCEPT OF DEPRECIATION

Return on equity is referred to as return on capital. It represents the money the investor makes on his investment. There is also a return of capital to investors. This takes the form of depreciation. When goods or services are produced, capital is used. In its physical form -- machinery, buildings, equipment -- it wears out and must be replaced if the stream of goods or services is to be maintained.

The Dictionary of Modern Economics defines depreciation as follows:

> The reduction in the value of assets generally from wear and tear. The consumption of capital is recognized as a cost of production and an allowance for this is made before net profit is arrived at. Conventional accounting seeks to allocate the decline in value of the asset over its projected economic life.1/

In the post-divestiture environment, the Federal Communications Commission and the local telephone companies argued that the return of capital had to be sped up through acceleration of depreciation schedules.2/ The rigors of competition, they argued, speed the process by which equipment is rendered obsolete and must be replaced. The economic life of assets is shortened by quickening technological progress in a competitive environment.

The FCC imposed faster depreciation schedules on the states. Many of the states had refused to accelerate depreciation, arguing that competition was weak and little change had taken place in the underlying technological processes which had typified the industry for half a century. As a matter of fact, rapid technological progress had certainly been made under slower state depreciation schedules.

As a matter of law, the Supreme Court agreed with the states. The FCC's effort to impose depreciation schedules on the states was ruled illegal in May 1986 (Louisiana Public Service Commission v. Federal Communication Commission et al., No. 84-871, May 27, 1986). States are now free to set their own intrastate depreciation schedules as they have been since the beginning of the industry.

EMPIRICAL ESTIMATION OF THE IMPACT OF DEPRECIATION ON CONSUMERS

Our observation that competition in the local telephone market has failed to materialize would support the argument that depreciation schedules should be slowed. It is extremely difficult to estimate how much they were sped up by the FCC policy and how much customers would save if there is a return to state policies because it is difficult to know when states implemented the FCC order and how much change they would have made on their own.

A floor estimate can be made by assuming that the FCC policy had relatively little effect in 1984 and full effect in 1985. The acceleration of depreciation expenses, relative to the asset base observed in 1985, can be attributed to the FCC policy.3/

Exhibit V-1 shows estimates of the cost to customers of accelerated depreciation in 1985 for each of the RBOCs and the RBOCs in aggregate. All of the RBOCs had increases in the depreciation rate. If those increases had not taken place, the revenue requirement would have been about $1 billion less.4/

DEBT

DEBT/EQUITY RATIOS

Regulated utilities finance their investments with more than equity capital. They typically use debt to finance a considerable part of their investment.

Debt is an attractive financing mechanism because it tends to cost less than equity.5/ Debt obligations are met before equity obligations, therefore they are considered less risky and earn lower returns.

EXHIBIT V-1
THE IMPACT OF ACCELERATED DEPRECIATION ON THE REVENUE REQUIREMENT
(Millions of Dollars)

COMPANY	DEPRECIATION RATE		DEPRECIABLE ASSETS, 1985	CONSUMER SAVINGS FROM 1984 RATE APPLIED TO 1985 ASSET BASE (Millions of Dollars)
	1984	1985		
AMERITECH	.073	.082	19545	175.91
BELL ATLANTIC	.062	.071	20772	186.95
BELL SOUTH	.066	.072	24993	149.96
NYNEX	.056	.063	22813	159.691
PACTEL	.058	.06	20493	40.99
SW BELL	.062	.066	19875	79.50
U.S. WEST	.062	.067	19496	97.48
RBOC TOTAL	N/A	N/A	147987	890.47

SOURCES: Depreciation rates are from Annual Reports. Ameritech, BellSouth and U.S. West are calaculated in the reports themselves. The other RBOCs have been estimated based on the formula:

Depreciation Rate = Depreciation Expense/ (Assets - Plant Under Construction)

Of course, if the risk inherent in the investment is high, then debt will be expensive too. Potential debt investors will not place much faith in the fact that their claim on the company will be met before equity claims, if they do not place much faith in the overall quality of the investment. Similarly, if too much debt is floated, potential investors will not place much faith in the fact that their claim comes before the equity claim, since the debt claim is large relative to the underlying assets. Within the constraints of excessive risk inherent in the company and excessively large shares of debt in its capital structure, inclusion of a significant role for debt financing of utilities lowers customers' cost.

Put the other way, expensive equity should not be allowed to play too large a role in the capital structure. There is no need to allow too much expensive equity financing when debt financing can do the job at lower costs.

EMPIRICAL EVIDENCE ON DEBT

The difficulty in determining the proper role of debt in the capital structure is similar to the difficulty in determining which companies are comparable or what investor expectations are. One must assess the nature of risk in the enterprise and determine the point at which additional debt financing ceases to lower costs.

Historically, equity financing of utility services has been in the range of 45 to 55 percent of total investment.6/ The argument presented at the onset of divestiture -- that the environment was much riskier for the RBOCs -- was also used in some cases to request an increase in the role of equity in the capital structure. With the competitive threat proving to be minimal and the turbulence of the divestiture process subsiding, it is time to revisit those decisions.

In order to obtain a general sense of how important the capital structure has been in recent rate increases we obtained data on the capital structure of the telephone company in the largest state served by each of the RBOCs.7/ We then calculated the savings to customers if the RBOCs companies were forced to return to the capital structure that was in place prior to divestiture.

This is tantamount to saying that the presumed increase in the risk associated with the divestiture did not pan out. Therefore it is legitimate to return to the prior capital structure which presumed a secure local monopoly and allowed debt to play a larger role. This is essentially the same argument made with respect to depreciation.

As Exhibit V-2 shows, the cost savings to customers would be in the range of a quarter of a billion dollars. One state served by each of the RBOCs was analyzed, then the estimate was grossed up to arrive at an RBOC total.

THE COST OF DEBT

Not only should the RBOCs rely on less equity and more debt in their capital structure, but it appears that their cost of debt should be reexamined. One of the important factors that has been cited as lowering the nominal return on equity -- the sharp decline in inflation -- has also been operating to lower the nominal cost of debt.

Between early 1984 and early 1986 the cost of debt declined by approximately three percentage points. This reduction of debt costs has not yet been factored into most regulatory decisions.

Those companies which have not had recent rate cases have a revenue requirement that embodies debt costs that are much too high. Even those companies that have had rate cases should be constantly prodded to keep reducing their interest costs as rates fall.

A three percent decline in the cost of new debt does not translate directly into any specific recommended decline in the overall cost of debt. Such a calculation requires specific, detailed knowledge of when debt was incurred, at what interest rate and how much refinancing will cost.

To gain some general sense of the magnitude of the potential savings to customers from a thorough reexamination of the cost of debt, we posit the following situation. If the RBOCs could roll over 10 percent of their debt in the next year at a rate of interest that is three percent lower than currently reflected in PUC decisions, that would lower the average cost of debt by three tenths of a percent (.1 x .03). With a total debt of $35 billion, such a reduction would save customers over $100 million.

Exhibit V-3 gives an indication that this is an entirely reasonable estimate. It identifies the portion of debt carried by the RBOCs that can be considered "high cost" debt. The RBOCs do not report the interest rate on their debt in detail or on a uniform basis. We have identified all debt carrying an interest rate above 9 percent as high cost debt since Corporate AAA rated bonds were earning 9.02 percent in the week ending June 28, 1986. That was prior to the reduction in the federal discount rate.8/ About a quarter of the outstanding RBOC debt was high cost by this definition.

EXHIBIT V-2
THE IMPACT OF INCREASING EQUITY IN THE CAPITAL STRUCTURE
(Millions of Dollars)

COMPANY	PERCENT OF COMMON EQUITY IN CAPITAL STRUCTURE		PERCENT OF PREFFERED PREFFERED STOCK		CONSUMER COST OF INCREASED EQUITY	GROSS UP TO RBOC LEVEL
	PRE-DIVEST.	POST-DIVEST.	PRE-DIVEST.	POST-DIVEST.		
ILLINOIS	52.8	53.0	2.2	6.3	5	37
PENNSYLVANIA	54.2	57.1	0	0	6	42
FLORIDA	NO CHANGE		NO CHANGE		0	0
NEW YORK	56.2	59.7	1.7	1.7	14	45
CALIFORNIA	41.5	48.3	5.2	3.8	42	88
TEXAS	55.0	55.0	0	0	1	7
WASHINGTON	45.0	45.0	3.0	3.0	0	0
TOTAL	N/A	N/A	N/A	N/A	68	219

SOURCE: Individual public service commissions. Company estimates use predivestiture capital structure and apply it to post-divestiturue capital costs. Figures are grossed up to the RBOC level by the following formula:

Company Increased Cost X (RBOC Assets/State Assets)

EXHIBIT V-3
INTERNALLY GENERATED FUNDS AS A PERCENTAGE OF GROWTH NEEDS

COMPANY	YEAR	
	1984	1985
AMERITECH	112	109
BELL ATLANTIC	100	103
BELL SOUTH	105	104
NYNEX	106	104
PACTEL	90	92
SW BELL	104	101
U.S. WEST	104	100

SOURCES: ANNUAL REPORTS. Defined as funds from operations divided by the sum of construction expenditures and dividends.

Exhibit V-4 shows how the reduction in the debt/equity ratio has come about. The telephone companies have been generating internal funds that meet or exceed their growth needs. Therefore, they have not had to rely on debt for financing. Even unregulated companies rely on debt to some extent. For example, Forbes magazine estimated that the largest 1000 corporations generated funds internally that covered only about 72 percent of their growth needs.9/ The RBOCs are doing much better than that.

In sum, the RBOCs have decreased their reliance on debt by utilizing the extremely generous returns to capital allowed by PUCs. This raises the cost to ratepayers. Increasing the ratio of debt in the capital structure and lowering their cost of debt would lead to a very conservative estimate of customer savings in the range of $200 to $400 million.

CONCLUSION

In this chapter we have examined costs to customers associated with capital other than return on equity. We have identified $1.2 to $1.4 billion in excess returns of and on capital.

EXHIBIT V-4
THE SHARE OF HIGH COST DEBT IN THE RBOC DEBT PORTFOLIO

RBOC	HIGH COST DEBT INTEREST RATES	TOTAL DEBT (Millions)	PERCENTAGE IN HIGH COST CATEGORY
AMERITECH	11 3/8% TO 17%	4518	12
BELL ATLANTIC	9 1/4% TO 16 3/8%	4891	34
BELL SOUTH	10 3/8% TO 16%	6471	26
NYNEX	11% TO 15 5/8%	5403	26
PACTEL	11 3/8% TO 16 1/4%	5803	29
SW BELL	11 3/8% TO 16 1/8%	5001	29
US WEST	9% TO 15 3/4%	4733	38
TOTAL	N/A	36820	28

SOURCES: ANNUAL REPORTS

VI. CONCLUSION

As Exhibit VI-1 shows, the aspects of capital discussed in this report equal about one-third of the revenue generated by the RBOCs. We have shown that each of these components of capital experienced unjustifiable increases in 1985.

Exhibit VI-2 summarizes the estimates of the cost to customers of these capital charges. We believe that the overcharge is in the range of $3 billion including

> excessive returns on equity costing customers between $1.25 and $2 billion per year;
>
> unnecessary accelerations of depreciation costing customers almost $1 billion per year;
>
> unjustified debt expenses costing customers between $.2 and $.4 billion per year.
>
> The RBOCs had a return on equity that was about 3.5 percentage points higher than other utilities and the largest coroporations in the nation. Their rate of profit was about one-third higher than these comparison groups.

The recent action by the FCC to lower rates of return on interstate access revenues, which did not reduce the return to capital sufficiently even in the interstate area, leaves the excess revenues of the RBOCs at approximately $2.5 billion.

Excessive returns to capital of that magnitude would account for virtually all of the increases in local telephone rates above inflation since divestiture (see Exhibit VI-3). The local phone companies were not catching up with inflation, as some have argued, but made a grab for excessive profits and excessively generous terms for capital investment. They used the pretext of and the uncertainty surrounding divestiture to pressure public service commissions into granting excessive concessions to telephone company stockholders.

The current market-to-book ratios enjoyed by the RBOCs are the best indicator that the concession were excessive. Under no circumstances can market-to-book ratios in the 1.4 range be justified for regulated monopolies.

If capital charges are reduced by $3 billion, that would equal a reduction in capital charges of 15 percent. This could translate into an accross-the-board rate reduction of about 5 percent. Because these are excessive returns to capital, such a reduction would not affect levels of service or actual operating

EXHIBIT VI-1
CAPITAL CHARGES COMPARED TO REVENUE
(Millions of Dollars)

RBOC	CAPITAL CHARGES (Net Income + Depreciation + Interest Expense)	TOTAL REVENUE	CAPITAL CHARGES AS A PERCENT OF REVENUE
AMERITECH	3103	9021	34.40
BELL ATLANTIC	3060	9084	33.69
BELL SOUTH	3904	10664	36.61
NYNEX	3045	10314	29.52
PACTEL	2763	8499	32.51
SW BELL	2839	7925	35.82
US WEST	2659	7813	34.03
TOTAL	21373	63320	33.75

SOURCES: ANNUAL REPORTS

EXHIBIT VI-2
SUMMARY OF CONSUMER IMPACTS OF POST-DIVESTITURE CHANGES
IN TREATMENT OF RBOC CAPITAL

CAPITAL COMPONENT	CONSUMER IMPACT (Billions of Dollars)
EXCESSIVE RETURN ON EQUITY	1.25 to 2.19
EXCESSIVELY RAPID DEPRECIATION	1.0
TOO LITTLE DEBT AND FAILURE TO LOWER THE COST OF DEBT	.2 TO .4
TOTAL	2.45 to 3.49

EXHIBIT VI-3
POST-DIVESTITURE RATE INCREASES COMPARED TO INFLATION
(Millions of Dollars)

COMPANY	TOTAL REVENUE 1984	TOTAL REVENUE 1985	1985 INCREASE ACTUAL	1985 REVENUE REQUIRED TO KEEP UP WITH INFLATION	INCREASE ABOVE INFLATION
AMERITECH	8347	9021	674	8647	374
BELL ATLANTIC	8090	9084	994	8381	703
BELL SOUTH	9631	10664	1033	9978	686
NYNEX	9573	10314	741	9918	396
PACTEL	7824	8499	675	8106	393
SW BELL	7191	7925	734	7450	475
U.S. WEST	7280	7813	533	7542	271
RBOC TOTAL	57936	63320	5384	60022	3298

SOURCES: ANNUAL REPORTS. Inflation is set at 3.6 percent.

expenses.

It is incumbent upon state public utility commissions to rectify this situation. The financial statistics of the RBOCS show beyond a shadow of a doubt that ratepayers are being significantly overcharged.

FOOTNOTES

CHAPTER I

1. The timing of increases is described in the National Telecommunications Information Administration, 1985a, 1985b. The importance of considering the timing of increases was pointed out in Cooper, 1986a.

2. A brief rendition of the company "liturgy" is given in Cross, 1986a. Earlier statements can be found in Wenders, 1984 and Spavins, 1984.

3. Cooper, 1984a:10-11. See also Cooper, 1984b. Evans and Rothschild, 1983 made a strong case that divestiture would not increase the RBOC cost of capital.

4. Pollack, 1986.

5. Langsam, 1986.

6. Pollack, 1986.

7. Coy, 1986.

8. The Annual Reports of the individual RBOCS show non-telephone revenues generally less than ten percent of total revenues. These non-telephone revenues include Yellow Pages revenues. There is a hot debate about whether they belong within the regulated entity (see Cross, 1986c). Measured by assets, non-telephone subsidiaries would be even smaller. The North American Telecommunications Association, 1986; and Spievak, 1986, maintain that the competitive subsidiaries are losing money and being cross-subsidized.

9. The only clearly profitable non-monopoly business is Yellow Pages.

10. Business Week, 1986b:84, commented on the efforts of electric utilities to diversify as follows

> The nation's utilities face a problem most people wish they had themselves: more money than they know what to do with... So managements are trying to put their excess funds to work with a strategy that many other industries have tried and abandoned; diversification...
>
> But the wisdom of diversification is not

> really the issue. What about customers who pay utility bills? They are the source of the excess funds. State regulators set utility rates to reflect costs, including those of capital construction, plus a reasonable return on capital. Since utilities are accumulating cash for which they have no clear need, rates are obviously too high. The best way to solve the utilities' excess-cash problem is for regulators to wake up and reduce rates to reflect today's cost of doing business. That would make utility customers happy, and management could go back to running the business they know best.

Since the RBOCs are outperforming the electric utilities to which Business Week referred, we believe the argument applies to them with even greater force.

CHAPTER II

1. Histories of the industry can be found in Meyer, et. al., 1980; Brock, 1981; and Gabel, 1967, for a different view of cost accounting.

2. Meyer et al, 1980, show the cost decline in clear fashion.

3. Cross, 1986b, points out that a number of Commissions have argued that if the threat of bypass exists, it results in the local company having a smaller part of an expanding pie, which still leaves the local company with a larger absolute volume of business.

4. A review of issues and surveys can be found in Racster, et al, 1984. A review of surveys and econometric studies can be found in Alpert and Ware, 1985. A general overview can be found in Kowal, 1984.

5. With respect to bypass of the system three types of data were produced -- surveys of potential bypassers (Bolter, 1984a,b; Bolter, et al, 1984; Touche Ross, 1984; Racster, et al, 1984), counts of potential and in place bypass technologies (Bolter, et al, 1984; Irwin, 1984), and hypothetical econometric studies of potential bypass (McKinsey, 1984, Booz Allen, 1985; Brock, 1984; Bell, 1984; Rolfs and Jackson, 1985).

6. Although many of the potential bypassers said they would get off the network for fairly small price differences (Touche Ross, 1984), they also stated that nonprice reasons were important.

7. Those who were skeptical of the bypass argument include Racster, et al, 1984; Bolter, 1984a,b; Schwartz, 1985; Cooper, 1984a,b.

8. Every one of the RBOC Annual Reports restates the competition argument.

9. See Foley, 1985; Catalano, 1985; Business Week, 1986a; and Data Management, 1985.

10. Economic Report of the President and Report of the Council of Economic Advisors (hereafter, CEA), 1986: Appendix B.

11. Bureau of Labor Statistics, Consumer Price Index (CPI) all telephones; Pollack, 1986.

12. CPI-All urban workers. Producer price index is from CEA, 1986: Table B-62.

13. No specific price index for computers exists. Business Week, 1986a, projects declines of 25 to 30 percent. Cost declines of that order of magnitude since divestiture are also shown.

14. CEA, 1986: Table B-62.

15. Ibid.

16. The decline in employment is from the RBOC Annual Reports. Wage increases are estimated from contract settlements.

CHAPTER III

1. The law of a fair rate of return has been established in two major Supreme Court decision -- Hope and Bluefield. The most frequently cited passages from these decision are:

(The Hope decision, FPC v. Hope Natural Gas Co, 1944:603)

> The investor has a legitimate concern with the financial integrity of the company whose rates are being regulated . . . By tnat standard the return to the equity owner should be commensurate with returns on investment in other enterprises having corresponding risk. The return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

(The Bluefield decision, Bluefield Water Works and Improvement Company v. Public Service Commission, 1923:692-693)

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.

2. Throughout this analysis we cite Kolbe et al, 1984 for arguments on the cost of capital. There are earlier discussion which reached similar conclusions (e.g. Gordon, 1974). There are caveats about accepting the cost of capital as the standard, caveats which relate to management incentives to overbuild the ratebase and otherwise distort the cost of capital or the market price of stocks (see Nelson, 1969).

3. Kolbe, et al, 1984:13.

4. This discussion presumes the prudence of investment and management decisions and the continued economic value of investments. Imprudently incurred capital costs deserve no return and investments whose economic value has been rendered questionable by market forces may not warrant a full rate of return (see Cooper, 1986b and Copeland, et al 1985, for a discussion of less than full rates of return on mistakes in retrospect).

5. Regulatory lag was a major topic of discussion during the high inflation years of the 1970s. The subsequent decline in inflation and the failure of public utility commissions to respond -- regulatory lag in reverse -- has received almost no attention.

6. Ibbotson and Sinquefield, 1977 and Merton, 1980.

CHAPTER IV

1. Langsam, 1986:2.

2. National Telecommunications Information Administration, 1985.

3. In general, less than one-third of the increases were in effect during 1984.

4. Vartan, 1986; Brown and Burkhardt, 1986, report on the strong performance of the RBOCS and the high regard in which the RBOCs are held.

5. Sherer, 1980, shows modest degrees of market power in non-regulated industries.

6. Kolbe, et al, 1984.

7. Annual Reports.

8. Cooper, 1985.

9. Cooper, 1985. The evidence clearly indicates that the natural monopoly characteristics of the telephone industry are stronger than for the electricity and natural gas industries. The economics of telecommunications exhibit strong economies of scale (see Fuss, 1983; Christiansen, Cummings and Schoech, 1983; Nadiri and Shankerman, 1979; Breslaw and Smith, 1980; Denny, Fuss and Waverman, 1981: Fuss and Waverman, 1980; Meyer, et al, 1980).

10. Kolbe, et al, 1984:47-51.

11. Kolbe, et al, 1984:85-87; Gordon, 1974.

12. Kolbe, et al, 1984:87-88.

13. Kolbe, et al, 1984:53-55. Breyer, 1982:45-46, expresses serious concerns about the DCF model.

14. Langsam, 1986.

CHAPTER V

1. Pearce, 1986:106. Nellis, 1985, makes the point that depreciation, like other regulatory variables such as relative risk, or expected returns, is far from an "objective" matter.

2. See Fogarty, 1986, for a vigorous statement of the case for accelerated depreciation.

3. This will underestimate the impact of the FCC policy to a certain extent, since the FCC decision certainly had some effect on depreciation rates in 1984. On the other hand, this approach could lead to an overestimation of the impact of FCC policy because the overall depreciation rate could accelerate because companies have added equipment with legitimately shorter lives in

recent years. Thus, these two factors offset one another. All things considered, we believe that that this approach provides a reasonable rock bottom estimate of the impact of accelerated depreciation schedules on rates.

4. Consider the case of Ameritech, for which company data is available. Our estimate of the impact of accelerated depreciation for 1985 is $176 million. Ameritech provided its own analysis in its Annual Report. It shows an increase in depreciation due to changes in rates and practices in 1985, compared to 1984, of $102 million (p. 38). In addition, there was an extraordinary item of $62 million. Thus, the total above and beyond changes in the asset structure was $162 million, close to our estimate of $175 million.

Moreover, Ameritech shows that the increase in depreciation in 1984 due to changes in rates and practices was $328 million. The total change in depreciation since divestiture due to changes in rates and practices was $428 million. Therefore, our estimate of $175 million is extremely conservative.

5. Kolbe, et al, 1984:16-19. Studness, 1986, has commented on the potential consumer savings from reducing the cost of embedded debt for electric utilities.

6. The Forbes, 1985, Annual Review of American Industry shows that debt constitutes approximately 48 percent of the asset base for electric utilities and 45 percent for natural gas utilities. The RBOCs are approximately 40 percent.

7. For Southwestern Bell we obtained the second largest state.

8. CEA, 1986b:30.

9. Business Week, 1985:June 24.

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STATE OF MICHIGAN

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April 24, 1987

The Honorable Howard M. Metzenbaum
Chairman, Senate Subcommittee on Anti-Trust,
Monopoly, and Business Rights
SR-140 Russell Senate Office Building
Washington, D.C. 20510-6275

Dear Senator Metzenbaum:

On behalf of the Michigan Public Service Commission (MPSC) I am writing you to express concerns with issues addressed in the Department of Justice (DOJ) Recommendations on line of business restrictions imposed on the Bell Operating Companies (BOCs) by the Modification of Final Judgment.

The Michigan Public Service Commission agrees with the DOJ recommendation that certain prohibitions against BOC provisions of information services be removed. We also agree with the concept of lifting some restrictions to BOC provision of interexchange services, but disagree with the parameters proposed by the DOJ.

Regulation of BOC lines of business must recognize state jurisdiction, as intrastate telecommunications service is directly affected. The law mandates that states regulate intrastate telecommunications operations, including the degree to which BOCs are permitted to engage in manufacturing, information and interLATA services.

Attached is a copy of the position the State of Michigan and the Michigan Public Service Commission filed in Comments to the United States District Court for the District of Columbia on this matter on March 12, 1987. These comments explain our position in greater detail.

I respectfully request that this letter and attachment be made a part of the record of the hearing scheduled for April 30, 1987 on the proposed modification to the AT&T Modified Final Judgment.

Very truly yours,

William E. Long

William E. Long, Chairman

Attachment

cc: Carl Levin, Don Riegle

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

v

Civil Action No. [illegible]

WESTERN ELECTRIC COMPANY, INC.,
AND AMERICAN TELEPHONE AND
TELEGRAPH COMPANY,

Defendants.

RESPONSE OF THE STATE OF MICHIGAN AND THE MICHIGAN PUBLIC SERVICE COMMISSION TO REPORT AND RECOMMENDATIONS OF THE UNITED STATES CONCERNING THE LINE OF BUSINESS RESTRICTIONS IMPOSED ON THE BELL OPERATING COMPANIES BY THE MODIFICATION OF FINAL JUDGMENT

MICHIGAN PUBLIC SERVICE COMMISSION

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1000 Long Boulevard, Suite 11
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DATED: March 12, 1987

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

v   Civil Action No. 82-019

WESTERN ELECTRIC COMPANY, INC.,
AND AMERICAN TELEPHONE AND
TELEGRAPH COMPANY,

Defendants.

_______________________________________/

RESPONSE OF THE STATE OF MICHIGAN AND THE MICHIGAN PUBLIC SERVICE COMMISSION TO REPORT AND RECOMMENDATIONS OF THE UNITED STATES CONCERNING THE LINE OF BUSINESS RESTRICTIONS IMPOSED ON THE BELL OPERATING COMPANIES BY THE MODIFICATION OF FINAL JUDGMENT

I.

INTRODUCTION

On February 2, 1987, the United States Department of Justice (DOJ) filed its first triennial Report and Recommendations to the Court concerning the line of business restrictions imposed on the Bell Operating Companies (BOCs) by the Modification of Final Judgment (MFJ), in which it addressed the question of whether, "in light of changes in competitive conditions, there is a continuing need for the decree's line of business restrictions." Report and Recommendations, p 2. Currently the BOCs are prohibited by the MFJ from providing interexchange telecommunications services or information services, manufacturing or providing telecommunications equipment, manufacturing customer premises equipment (CPE), and from providing any product or service other than as specifically allowed under the MFJ.

During the three years since divestiture, there have been innumerable petitions by various BOCs for waiver or removal of the restrictions pursuant to § VIII(C) of the MFJ which provides that a BOC may enter otherwise prohibited lines of business upon a showing that there is no substantial possibility that the BOC could use its monopoly power to impede competition in the market it seeks to enter. 552 F Supp at 231. This process by which

BOCs may obtain waivers has proven to be costly and time consuming, and the DOJ therefore further addressed the question of whether the Federal Communications Commission (FCC) might be better positioned than the Court and the DOJ "to address the relevant competitive concerns as part of a broader technical, economic and policy context." Report and Recommendations, p 6.

Resolution of these two questions directly affects the citizens of the State of Michigan, as well as Michigan Bell Telephone Company, over which the Michigan Public Service Commission has direct supervisory powers pursuant to MCL 460.1 et seq; MSA 22.13(1) et seq; MCL 484.101 et seq; MSA 22.1441 et seq. The State of Michigan and the Michigan Public Service Commission (MPSC) therefore submit the following response to the recommendations of the DOJ.

II.

INTEREXCHANGE SERVICES

The DOJ recommended that: (1) BOCs be permitted to provide interexchange services that are entirely outside of its region, (2) each BOC should continue to be prohibited from providing interexchange services originating or terminating in any area where the BOC enjoys a legally protected local monopoly, (3) if, in the future, a BOC shows that all regulatory barriers to entry and resale have been removed in particular exchange areas within its region, the BOC should be allowed to provide interexchange services among such unrestricted exchange areas or among one or more such exchange areas and any points outside the BOC's region. Report and Recommendations, p 59, 60.

The State of Michigan and the Michigan Public Service Commission agree with the concept of lifting some restrictions to BOC provision of interexchange service, but disagree with the parameters proposed by the DOJ. The current prohibition against BOCs competing in the area of new service offerings results in increased costs for the only service the BOCs are permitted to offer--basic local service. Such increase in the cost of basic local service has a potential for adversely impacting upon the provision of universal service. We propose, therefore, that to the degree that a new service may be provided as an integral part of a BOC's existing business, and will improve the existing network, it should be allowed.

Thus, contrary to the DOJ recommendation we would allow a BOC to enter the interLATA market within its own state where its customers would receive an economic benefit from services added to the network at minimal cost. The advantages in reduced cost of basic local service outweigh the unlikely potential for anti-competitive behavior.

On the other hand, we would continue the prohibition against provision of interexchange services to remote out of state LATAs, where the cost of constructing new networks would negate the economic benefit to local customers.

III.

INFORMATION SERVICES

The DOJ has recommended that the MFJ prohibition against BOC provision of information services be removed. Report and Recommendation, p 104. We agree. As in the case of interexchange services, we believe that loss of revenues by the BOCs to competitors by virtue of the prohibition results in increased costs of basic local service. Further, the BOCs may implement new technological capabilities more quickly as add-on services to their existing networks with little or no incremental cost. To this end, we also advocate repealing structural separation requirements, thereby eliminating duplicative overhead costs. This would allow for faster expansion to rural and remote areas. Customers may once again engage in more "one-stop shopping" when dealing with the carrier or service provider of their choice. By lifting the restriction against BOC provision of information services, the Court will enhance the likelihood that such services will not exist, as other smaller service providers are not equipped to offer them.

The rationale for the prohibition, and the circumstances under which it arose no longer adhere. As indicated by the DOJ, very few information services were offered to the public in 1974 when the complaint was filed; and in 1982 when the parties agreed to the MFJ, most information services were in a formative stage. One of the underlying assumptions of the prohibition was that information service providers would be dependent on local exchange facilities, as well as the recognition that technological or structural changes could decrease that dependence. As a practical matter, large customers, with their own PBX switching systems, are now able to access a number of information services which smaller customers who depend on the BOC's public networks are prohibited from receiving. The alternatives to BOC networks are often more costly, inconvenient, and more confusing than services the BOCs might offer were the restriction against such offerings removed.

IV.

TELECOMMUNICATIONS EQUIPMENT AND CUSTOMER PREMISES EQUIPMENT

The DOJ has recommended that the MFJ's prohibition on manufacturing of equipment should be removed. Since divestiture, equipment markets have changed dramatically, and the virtual monopoly that previously existed has been replaced by strong competition. The rationale for the restrictions for purposes of protecting customers from the discrimination and prices resulting from such monopoloy power no longer exists. Therefore, we agree with the DOJ recommendation as long as manufacturing is related to and is an integral part of telecommunications service. Subsidization flowing from basic service to unrelated risk ventures must be avoided.

V.

NONTELECOMMUNICATIONS BUSINESSES

The DOJ has recommended that the restriction against BOC participation in nontelecommunications businesses be eliminated and that no separate subsidiary condition be imposed with respect to such businesses. The recommendation was based on the DOJ's perception that the fear of improper cross-subsidization has not been borne out in a review of the case-by-case waiver process which has occurred.

Without addressing the question of whether the potential for cross-subsidization of noncommunications businesses is a problem, the State of Michigan and the Michigan Public Service Commission disagree with the DOJ's recommendation for the same reasons that we oppose the expansion of interexchange services to regions outside of the BOC's service territory. That is, the only legitimate public interest purpose in allowing BOCs to enter lines of business is to benefit the ratepayer in the form of reduced costs. Allowing business ventures outside of the BOC's traditional expertise may increase the business risks of the BOC and, therefore, potentially lead to increased costs and customer rates. Removing this restriction, therefore, is inappropriate.

VI.

REGULATORY JURISDICTION

The Federal Communications Act of 1934, specifically §152(a) and (b), 47 USC 152(a) and (b), establish a "dual-jurisdictional" framework with respect to the regulation of telecommunications services. Section 152(a), 47 USC 152(a), provides the Federal Communications Commission with jurisdiction over interstate and foreign telecommunications. On the other hand, § 152(b), 47 USC 152(b), provides separate and fully effective regulation of intrastate telecommunications by the states, and states in relevant part as follows:

> "Except as provided in section 224 of this title and subject to the provisions of section 301 of this title and subchapter V-A of this chapter, nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier...."

(The exceptions referenced above are not applicable to this case since § 224 deals with attachments by cable television systems to certain plant owned by a utility, § 301 deals with licenses for radio communication or energy transmission, and subchapter V-A deals with cable communications.)

The United States Supreme Court, in Louisiana Pub Serv Comm'n v Federal Communications Comm'n, 476 US ___; 90 L Ed 2d 369 (May 1986) has upheld this jurisdiction split, or dual-jurisdictional framework, established by the Federal Communications Act of 1934, 47 USC 152(a) and (b), finding that the FCC and federal courts could not pre-empt the states with respect to state regulation of intrastate telecommunication matters. In relevant part, the Supreme Court stated:

> "The Act establishes, among other things, a system of dual state and federal regulation over telephone service, and it is the nature of that division of authority that these cases are about. In broad terms, the Act grants to the FCC the authority to regulate 'interstate and foreign commerce in wire and radio communication,' 47 USC § 151 [47 USCS § 151], while expressly denying that agency 'jurisdiction with respect to . . . intrastate communication service . . ." 47 USC § 152(b) [47 USCS § 152(b)]."
> 90 L Ed 2d 369, 376

In accordance with this holding, regulation of BOC lines of business must recognize state jurisdiction, as intrastate telecommunications service is directly affected. A transfer of such regulation from the Court to the FCC to the degree it doesn't recognize the dual jurisdiction would be simplistic and unlawful.

We continue to support the Joint Board process of engaging in a federal-state cooperative effort to establish regulatory standards and methodologies. However, we disagree with any action which might undermine a dual regulatory scheme. The law mandates that states regulate intrastate telecommunications operations, including the degree to which BOCs are permitted to engage in manufacturing, information and interLATA services.

Respectfully submitted,

STATE OF MICHIGAN

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DATED: March 12, 1987

ERS/2USDC/R0192-1

CERTIFICATE OF SERVICE

I, Elizabeth R. Schwartz hereby certify that I have served a copy of the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Lansing, Michigan, this 12th day of March, 1987.

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STATE OF ILLINOIS
Illinois Commerce Commission

MARY B. BUSHNELL
Chairman

527 East Capitol Avenue
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April 24, 1987

The Honorable Howard K. Metzenbaum
Chairman, Subcommittee on Antitrust and Monopoly Business
Practices, Committee on the Judiciary
United States Senate
Washington, D.C. 20510-6275

Dear Senator Metzenbaum:

The Illinois Commerce Commission (Commission) has been an active participant in the debate over the line-of-business restrictions imposed on the Regional Bell Operating Companies (RHCs). Its most recent comments on this matter were submitted to the U.S. District Court in response to a request for comments on the status of the Modified Final Judgment issued by Judge Harold Greene. The Commission appreciates the opportunity to place its views on this matter before the Subcommittee for its consideration.

The Commission unanimously adopted the attached Statement of Position in response to the Department of Justice comments to the federal court which recommended the removal of most line-of-business restrictions imposed by the Modified Final Judgment. It has been the long-standing policy of the Commission to oppose continuance of the line-of-business restrictions imposed on the RHCs. Specifically, the Commission advocated the following four points:

1. Removal of the prohibition against provision of information services.

2. Removal of the provision against the manufacture of central office equipment and customer premise equipment.

3. Removal of the bar against provision of long-distance service that is provided outside the RHCs' own local exchange service areas.

4. Prevention of cross subsidization between monopoly services and competitive services through various accounting, structural and regulatory mechanisms.

The Commission is keenly aware of the controversy attending the call for removal of the line-of-business restrictions on the RHCs. The Commission is therefore anxious to make its views on this issue a matter of public record. While the Commission would have preferred the opportunity to appear before the Subcommittee and present its views, it nonetheless appreciates having its Statement of Position entered on the record of proceedings.

Sincerely,

Mary B. Bushnell

Mary B. Bushnell

Attachment

cc: The Honorable Paul Simon

REPLY COMMENTS
OF THE
ILLINOIS COMMERCE COMMISSION
ON THE
DOJ REPORT AND RECOMMENDATION
CONCERNING THE LINE-OF-BUSINESS RESTRICTIONS IMPOSED ON THE REGIONAL BELL OPERATING COMPANIES

CIVIL ACTION NO. 82-0192

This Statement of Position was Approved by the Illinois Commerce Commission on March 31, 1987.

Prepared by

Policy Analysis & Research Division
Telecommunications Program
Illinois Commerce Commission

With these comments, the Illinois Commerce Commission expresses its support for the Department of Justice (DOJ) report and recommendation calling for removal of most line-of-business restrictions imposed on the Bell Regional Holding Companies (RHCs) as a result of the Modified Final Judgment (MFJ). In the past, the Illinois Commerce Commission has submitted comments in opposition to continuance of the line-of-business restrictions. This opposition is a long-standing policy of the Illinois Commerce Commission. In these comments, this Commission specifically addresses four key areas.

1. The Commission supports the DOJ's recommendation that prohibitions placed on the RHCs with regard to provision of information services be removed. As stated in previous comments, the provision of information services is a logical extension of basic exchange service. The removal of these restrictions will result in the availability of new services for customers, and may result in decreased basic service costs because of the savings associated with the sharing of local exchange facilities.

2. This Commission also supports the DOJ's recommendation to remove the prohibition against RHCs' manufacturing of central office equipment and customer premise equipment. The manufacturing prohibition was based on the concern that RHCs could impede competition in the equipment markets. However, as stated in previous ICC comments, each RHC is but one of many consumers of network equipment worldwide. No single entity's purchasing decisions can dominate the global competitive markets.

3. With respect to restrictions on RHCs' provision of long-distance services, the Illinois Commerce Commission has previously voiced its opinion on this matter, as well. In its comments of September 18, 1986 the Commission stated:

> "It must be noted, however, that the Commission does not believe it is appropriate at this time to allow the Bell Operating Companies to provide interLATA services. Advocacy of this position represents a difficult decision by the Commission-----long a defender of increased competition in the provision of utility services. The Commission takes this position out of concern that the entrance of the Regional Bell Holding Companies into the interLATA market may jeopardize developing competition. This danger

> is especially great when RBOCs are capable of providing end-to-end service. On this matter, the Commission believes that it is far better to err on the side of safety for the time being. In no way, however, should a prohibition on interLATA entry be a permanent one. In the long run all prohibitions on competitive entry should be removed. This removal could occur as early as 1988, however, further study is warranted."

The DOJ recommends that RHCs continue to be barred from providing long-distance service to, or within, areas in which the companies' provide local exchange service. This Commission agrees. The DOJ also recommends that RHCs be allowed to provide long-distance service outside the RHCs' own local exchange service areas. This Commission agrees with this recommendation as well. These recommendations reduce this Commission's concerns about the lifting of interexchange service restrictions. The DOJ's proposal on this latter point, however, raises questions as to whether such a recommendation encourages duplication of facilities which would not otherwise occur.

4. Finally, in expressing its support for some of the DOJ recommendations, this Commission reiterates the Illinois position, expressed in previous comments, that cross subsidizations between monopoly services and competitive services can and should be effectively prevented through various accounting, structural and regulatory mechanisms. Furthermore, state regulators should impose additional safeguards, either individually or collectively, as deemed necessary.

In summary, this Commission favors the DOJ's recommendation removing most of the line-of-business restrictions on the RBOCs. The current restrictions are barriers denying customers benefits -- the offering of new services and the cost savings associated with competition -- which normally flow from competition.

Respectfully,

Mary B. Bushnell

Mary B. Bushnell
Chairman
Illinois Commerce Commission

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April 29, 1987

Chairman Howard Metzenbaum
Senate Subcommittee on Antitrust,
Monopolies, and Business Rights
Washington, D.C.

Dear Mr. Chairman:

I respectfully request that my attached comments be admitted in the record of the hearings being held on the important issue of revision of the Modified Final Judgment in *United States* v. *Western Electric Company*, Civ. Act. No. 82-0192. I strongly support the recommendations of the Department of Justice for the reasons set forth in the comments.

The basis of my recommendation is long experience in the area, as General Counsel of the FCC (1964-1970), Assistant to the Chairman of the FCC (1970-73), and Assistant Secretary of Commerce for Communications and Informantion (and NTIA head -- 1978-1981). Since leaving Government, I have been Director of the Washington Center for Public Policy Research, a branch of Duke University.

The comments represent my disinterested views. I am not now, nor have I ever been, retained by any private entity in the communications field. Further, the comments reflect my long held views, as shown by the enclosed article in Issues in Science and Technology, Winter, 1986, National Academy of Sciences, *Telecommunicatioms Policy Today: Against Technology*.

Thank you for receiving my views. I commend you for holding these proceedings on a matter so important to the future of our nation.

Sincerely yours,

Henry Geller
Director

COMMENTS OF HENRY GELLER
Before the Senate Subcommittee
on Antitrust, Monopolies and Busniness Rights
on Revision of the Modified Final Judgment
as to the Restrictions on the Divested Bell Companies
April 30, 1987

I. THE APPROPRIATE STANDARD FOR REVIEW IS THE COMPETITIVE COST-BENEFIT STANDARD.

Initially, there is the issue of what standard should govern the issue of review of the restrictions on the Bell Operating Companies (BOCs) in the Modified Final Judgment (MFJ) in *United States* v. *Western Electric Company*, Civ. Act. No. 82-0192. One standard which has been used for judicial review of consent decrees is based on changed circumstances.[1] In other words, the Antitrust Court can determine whether revisions in a consent decree are warranted by circumstances that have occurred since the entry of the decree which could not have been foreseen at the time the judgment was entered and which have transformed the decree into "an instrument of wrong."

There have been substantial changes as Justice has pointed out in its recent Report to the Antitrust Court (herein "Justice Report") -- changes in the market (e.g., the emergence of seven *independent* and competitive RBOCs; the clearly demonstrated ability of large telecommunications users to meet their non-switched telecommunications needs in a variety of ways; the large scale construction of modern long-haul facilities by a variety of carriers and other entities), and changes in the regulatory environment (e.g., the FCC's decisions in the *BOC Waiver* orders *Waiver* orders and *Computer Inquiry III*[2]). These changes must be taken into account.

However, the case for revision of the MFJ should not rest primarily on changed circumstances. Rather, in my view, it should rest on the competitive cost-benefit analysis suggested by the Justice Department.[3] This approach, I believe, is consistent with the general standard incorporated into the MFJ by the Antitrust Court.[4]

U.S. policy does not favor the suppression of competitors and such suppression should be undertaken only for the most compelling reasons. Stated differently, if the benefits of allowing competition significantly outweigh any detriments, clearly sound antitrust (and communications) policy strongly militates for allowing the competitive entry.

There are substantial competitive costs in "parking out" the seven RBOCs, especially with regard to information services and manufacturing. Allowing BOC entry is not risk-free from the competitive standpoint. It creates a "messy" situation that must consumers and all competitors). But under the present circumstances, the balance tips massively in favor of BOC entry into information services, manufacturing and, in some instances, even interexchange services.

I should also acknowledge that as an intervenor I used the same standard to argue to the Antitrust Court in 1982 that the restrictions on information services and on marketing of equipment which were contained in the proposed decree should not be imposed.[5] I thus strongly believe that the restrictions on information services were mistaken antitrust policy ab initio, and that subsequent events have simply underscored that mistake.

I discuss below the three areas of major concern -- information services, manufacturing and interexchange (interLATA).

II. THE BAR ON BOC PROVISION OF INFORMATION SERVICES SHOULD BE REMOVED.

I support Justice's recommendation that the information services prohibition be removed. The Justice Report has set out in detail the nature of these information services, and I see no purpose in covering the same ground in these brief comments.

I do not argue, as some do, that permitting the BOCs to provide information services will result in a cornucopia of innovative service offerings that will transform POTS ("plain old telephone service") into PANS ("pretty advanced new stuff") overnight. Rather, I believe, as I stated in 1982, that the restriction prevents the BOCs from augmenting basic telephone service with a number of valuable features which could be offered efficiently within the telephone network (e.g., "Custom Calling II"). It also inhibits the upgrading of the network over time to offer new services. In short, the restriction on information services works against technology in a manner which could harm consumers.

If the last five years have proven anything, it is that the future of information services is uncertain. Many promising new services have failed in the marketplace (e.g., videotext services). Information services do not represent easy opportunities; they require great skill and expertise to foster and bring to fruition. The BOCs possess the expertise and the necessary resources which can make the difference between success and failure in the future for at least some types of information services (e.g., network processing, electronic directory services). Indeed, some information services may not develop at all or may be unavailable to all subscribers unless the BOCs are permitted to use their networks to the maximum extent possible. In other instances, the BOCs might engage in joint ventures with firms which have expertise they lack to provide information services. Further, in some cases, the mere possibility of entry by the BOCs may drive other firms to offer new services which those firms might otherwise have held back.[6]

We should not forget that a major driving force behind AT&T's agreement to the MFJ and divestiture of two-thirds of its assets was its need to eliminate the 1956 Consent Decree, preventing its entry into information processing. By 1982, it was widely acknowledged that the 1956 Consent Decree constituted bad policy. In particular, the Decree reduced competition in the computer industry by eliminating what might have been IBM's most formidable competitor.[7] Yet, we have repeated that policy as to the BOCs, similarly situated and driven to enter the new information services. One need only look to the actual example of GTE -- in effect, the equivalent of a BOC (with $12 billion in assets). GTE's entry into information services has markedly bolstered competition and served the public interest. Suppressing GTE would clearly result in a large net loss.

The benefits derived from BOC entry into information services can be very substantial. However, there are potential detriments as well. The BOCs still retain the ubiquitous local switched network and thus the telecommunications highway to residences and small businesses. This switched highway does constitute core or bottleneck facilities, and there is no indication the bottleneck will be significantly reduced or eliminated even in the next decade. It follows that other than CPE-based competition (i.e., PBX competition with Centrex), competitors like value-added networks will continue to rely on the local switched network and thus remain dependent on the same BOCs which would now become their competitors in offering information services. This situation creates risks of unfair competition through improper cross-subsidization and discriminatory interconnection.

The FCC has sought to deal with the issue of improper subsidization through two means. As part of its Computer Inquiry III decision, the FCC required that dominant carriers provide enhanced services through fully separated subsidiaries (FSS). It is generally accepted that the FSS prevents cross-subsidy. However, there has been increasing concern that it may also prevent efficient integration. In responding to this concern, the FCC is proceeding cautiously to develop accounting safeguards as an alternative to the FSS. Thus, if the BOC wishes to integrate the information service within the network (as in the case of protocol and code conversion), the BOC would have to adhere to strict accounting procedures (including independent annual audits) to deal with facilities jointly used for the competitive information service and the monopoly basic telecommunications enterprise.[8]

While neither the separate subsidiary nor accounting rules represent perfect solutions to the problem of improper cross-subsidization, they substantially reduce the detriments. Thus, they add to the overwhelming balance in favor of allowing competitive entry by the BOC.[9]

I believe that it is equally important to afford competitors fair interconnection to the BOC core facilities. Here again the FCC, in its Computer Inquiry III decision, offers the BOC two ways to proceed. The BOC can offer enhanced or information services through a fully separated subsidiary (FSS), in which case both the subsidiary and its competitors interconnect with the BOCs' telephone network on the same terms. Alternatively, the BOC can dispense with the FSS as to a specific enhanced service but only after demonstrating to the Commission that it will afford competitors "comparably efficient interconnection" (CEI). This alternative process carries with it certain costs and risks for the BOC. Gaining FCC approval will undoubtedly take time and involve the resolution of potentially complex issues. In this sense, it is certainly not deregulatory. However, it may eventually permit a BOC to offer an information service without sacrificing the efficiencies of integration.

The long range solution to the problem of interconnection advanced by the Commission and endorsed by Justice is Open Network Architecture (ONA). ONA is the centerpiece of the Computer Inquiry III decision. While ONA is still more a concept than a defined term, it looks to the unbundling of basic network service elements (and also enhanced nodes). In other words, ONA would constitute a set of general interfaces which, once developed, would avoid the need for lengthy ad hoc proceedings as are required for CEI.

Further, ONA could promote development of new information services in competition with those offered by the BOCs since competitors will be able to use the general interface without risking disclosure of their business plans to the BOCs. The BOCs could also benefit in an ONA environment since they could bring new services to market much more quickly than they can today when they encounter delays of up to several years while switches are being re-programmed. Additionally, the BOCs can offer service innovations in an ONA environment without disclosing those innovations in advance to switch manufacturers (e.g., AT&T).

I think that the Commission is proceeding soundly in calling for the submission of ONA plans by the BOCs by February 1, 1988.

The Commission, however, has wisely not made ONA a prerequisite for BOC entry into an enhanced service, and neither, we urge, should the Court. ONA is a concept that will evolve over time. While it should be encouraged by the Government, I strongly believe that it would be a mistake for its progress to be ordained by governmental fiat. Rather, it must evolve with the technology and the demands of the market. In the meantime, the public interest is safeguarded, adequately if imperfectly, by the requirement for either an FSS or CEI, along with the Commission rules as to accounting, independent audits, disclosure of network changes (the make/buy requirements) and protection of confidential customer data.

Clearly, the FCC is proceeding to deal with the issues of cross-subsidy and interconnection. Thus, there is no reason to assume any regulatory neglect, incompetence or failure on the part of the expert agency.

The competitive balance which markedly favors BOC entry into information services extends also to the issue of electronic publishing. While the BOCs, for the most part, have no special expertise in publishing, they are the logical entities to provide electronic directory service (including "electronic yellow pages") and similar endeavors.[10] There is every reason to allow such endeavors subject to the same safeguards which apply to the provision of other information services. To fence off this market is economic protectionism, I believe, and therefore I fully concur with Justice that "the Computer III rules should be adequate to eliminate any competitive concern that might arise from BOC provision of electronic publishing."

There is one last important point regarding BOC provision of information services. As the expert regulatory agency, the Commission has laid down the conditions which it believes are needed and has a continuing process to refine both the conditions and their implementation. It would, I submit, be poor policy and lead to great confusion and needless expense if the Antitrust Court were now to enter the same field, either by imposing additional conditions or even by imposing similar conditions as part of the judicial process. This dynamic regulatory process should be left to the regulatory agency, subject to the Administrative Procedure Act, appellate court review and Congressional oversight.

In this regard, I note that the competing enhanced service providers have demonstrated their ability to protect their interests before the Commission in the Computer Inquiry III and BOC Waiver Order proceedings. This experience fully supports the adequacy and desirability of leaving this essentially regulatory process to the administrative agency.

In sum, I believe that the Antitrust Court should simply remove the restriction on information services and leave both the conditions and their implementation to the regulatory process. The Court should not intervene, even to the extent indicated by Justice.[11] The Court should obtain periodic reports from Justice, and it should re-enter the field, most likely upon petition of the Department, only if there is an egregious breakdown in the regulatory process. Of course, Congress, if it wished, could and should embody the above position in legislation.

III. THE RESTRICTION ON MANUFACTURING CUSTOMER PREMISES EQUIPMENT AND TELECOMMUNICATIONS EQUIPMENT SHOULD BE REMOVED.

Here again little discussion is needed in light of the Justice Report. Competition in the manufacturing of customer premises equipment (including terminal equipment and PBXs) is fierce. Many of the competitors are large enterprises, with substantial vertical integration into telecommunications services (e.g., AT&T, Northern Telecom, IBM, Siemens, and NEC). The established presence of these firms, along with the protections provided by the FCC's registration program,[12] means that entry by the BOCs into the manufacturing of CPE would be unlikely to impede competition.

The market for network equipment (switching and transmission) must be viewed differently. This market is much more concentrated, especially the market for central office switches which is essentially a duopoly dominated by AT&T and Northern Telecom. In addition, there are valid public policy and antitrust concerns about the BOCs favoring a manufacturing subsidiary which is less efficient than its competitors.

On balance, however, I come down strongly in favor of lifting the restriction on manufacturing. In the first place, there is the obvious concern about forcing the BOCs to continue to rely on a major competitor -- AT&T -- for their switching needs. As Open Network Architecture evolves and as the BOCs begin to offer information services, it is imperative that they be able to control their own destiny by establishing their own manufacturing capabilities or by engaging in joint ventures with others. Without the capability to manufacture, the BOCs are not likely to engage substantially in the R&D that is vital in dynamic markets. Moreover, there are a host of other activities including one-of-a-kind installations, software development and development of product specifications which may be said to include elements of "manufacturing." Thus, the prohibition on manufacturing casts a cloud on such activities and might, at some point, preclude them altogether.

As to potential abuses of market power by the BOCs in the purchasing of network equipment, I believe that no matter how much or how little monopoly power a BOC has, it cannot earn significantly more monopoly rents by producing its own network equipment. It will therefore use alternative suppliers unless it can produce the equipment more cheaply.[13]

Thus, I support Justice's recommendation that the restriction on manufacturing be removed. I think that the potential benefits far outweigh any harm to competition. In fact, I believe lifting the manufacturing bar will create additional competition and eliminate the duopoly which exists in the manufacture of central office equipment.

IV. THE RESTRICTION ON "IN-REGION" INTERLATA SERVICES SHOULD BE NOT BE MODIFIED AT THIS TIME.

I agree with Justice that the BOCs should be allowed to engage in out-of-region interLATA or interexchange service. The crux of the nationwide prohibition on BOC provision of interexchange service in the MFJ is BOC control of bottleneck facilities in the local exchange. At the time the MFJ was entered, Justice feared BOC competition in nationwide interexchange services would frustrate the goal of achieving "equal access" to those local exchange facilities for all interexchange carriers. These fears stemmed, in part, from the fact that it was not clear at that time how AT&T's plan of divestiture would divide the local exchange markets. There was nothing in the decree which would have prevented AT&T from spinning off the local exchange portions of its business into a single firm.

However, in view of the divestiture which occurred (creating seven regional BOCs), the significant progress which has been made towards achieving equal access (implemented in over 70 percent of the lines served by the BOCs[14]), and the fact that the regional companies do not control bottleneck facilities outside their region, I certainly endorse Justice's decision to recommend lifting the out-of-region restriction.

I also agree with Justice that a problem remains in terms of a BOC's control of bottleneck facilities within its region. As Justice points out, there have been significant developments since the entry of the MFJ in 1982. Equal access is a reality in most areas, including the regions of greatest competitive importance. Alternative networks, which provide end-to-end competition with the telephone network, do not depend on local exchange facilities at all.[15] Shared-tenant systems have replaced at least a portion of the local switched network, especially in jurisdictions which do not require partitioning the PBX (e.g., Illinois, Virginia). With the costs of radio-based systems and switching expected to decline and with the expansion of local fiber networks expected to continue, this competitive trend in local distribution is likely to continue in the future.

However, this is not to suggest that the BOC bottleneck has been broken. For residence and small business customers, there are no effective alternatives today. And even for the large user who does have alternatives to LEC access services, there is no practical alternative to the LEC switched network for local service.

Moreover, I agree with Justice that the legal barriers to entry into local and intraLATA toll services, including resale of BOC services, are substantial. The Antitrust Court has already noted the incongruity of a BOC seeking to engage in all competitive markets while, at the same time, arguing to remain the monopoly carrier in markets protected by state regulation (e.g., intraLATA toll).[16] I agree with the Court and with Justice that sound policy requires both the elimination of the legal barriers and the provision of equal access to the new entrants.

Justice correctly believes that the BOCs should not be permitted to provide any in-region interLATA service until all intraLATA services be removed and that non-BOC carriers, private users and others be able to provide "for themselves or for others, all forms of intrastate or interstate transmission and exchange services."[18] These objectives of Justice are sound, and I endorse them.

I acknowledge the cogency of the argument presented by some that the large user starts on a different footing -- and that substantial competitive benefits would flow from allowing the large user access to the BOCs for interexchange service. But I am much concerned that if the BOCs are permitted access to the large users, this will very largely remove any incentive to get on with the full transition to open competition. After all, the competitive struggle has always focused on the large customer.

There is an additional consideration here which I believe is important. In 1982, the Government put into effect a policy that invited heightened competition in interLATA toll services through divestiture of the essential local "tails," proscription of interLATA service by the divested local companies, and equal access. That policy did not indicate to the new toll competitors that the proscription would last only until equal access was afforded. If that were the sole criterion, why require divestiture? On the contrary, it was, in effect, implied that the policy would continue until elimination of the bottleneck.[19]

Competitors have responded with large investment programs, particularly in fiber optic networks. Indeed, for some time there may even be over-capacity shortly in this toll field.

In these circumstances, I believe that the Government has some duty to the competitors to adhere to the established ground rules for a reasonable period of time. That period has not yet ended. Competitors like U.S. Sprint and MCI are just now bringing to full fruition their extensive investments in fiber, etc. Therefore, I believe that the ban on in-region interLATA service should be continued and re-examined again by the Antitrust Court at the end of another three-year period, with particular reference to the state of interexchange competition at the time. Of course Congress could also engage in such review at that time.

In my view, this situation differs from the restrictions on information services and manufacturing. The latter two areas were not the reason for divestiture; they were "add-ons" by the Department of Justice in the MFJ process. Information service providers have not been induced to enter by reason of divestiture or its restrictions. There is no comparable local/intraLATA competitive barrier problem that must be confronted in resolving the issue as to BOC in-region entry; the BOCs do engage in toll service (intraLATA) and gain very substantial revenues from such service (and access charges). And there is a strong need for BOC entry into the information service field (and also manufacturing); while BOC participation in in-region interLATA services would supply worthwhile additional competition, it is not so urgently needed in light of the apparent present competitive efforts.

In any event, the famous Holmes' maxim -- "the life of the law is not logic; it is experience" -- is apt here, and that experience augurs for retention of the ban and re-examination of the issue in three years.

V. THE AT&T DIVESTITURE HAS PRODUCED POSITIVE RESULTS. HOWEVER, THE BENEFITS OF DIVESTITURE COULD BE LOST IF THE LINE-OF-BUSINESS RESTRICTIONS IN THE MFJ ON INFORMATION SERVICES AND MANUFACTURING ARE NOT ELIMINATED AT THIS TIME.

As a Government official during the period leading up to the MFJ, I never urged divestiture as a solution to the problems posed by the Bell System's market power. But it was the solution -- the most drastic one in antitrust histority. And I believe that when the MFJ is reviewed at the end of this century, it will be judged to have been a resounding success.

It is true that the breakup of the integrated, end-to-end network had significant costs. But it had become increasingly clear that one company simply could not be permitted to control the enormous telecommunications and information movement/ management needs of the United States. By breaking up AT&T into eight large and resourceful entities, we have injected needed plurality and efficiency into the telecommunications infrastructure of the country and positioned ourselves well to meet the growing international competition in this field.[20]

It follows that governmental policy should act to promote and reap the full benefits of that pluralism. The Justice Report, by urging elimination of the restrictions on information services and manufacturing, moves soundly in that direction. The recommendations contained in the Justice Report should be affirmed and implemented by the Antitrust Court and endorsed by the Congress in its oversight process (or if it chooses, by specific and promptly passed legislation). They are clearly in the public interest.

ENDNOTES

[1] See U.S. v. Swift & Co., 286 U.S. 106, 119 (1932).

[2] Petitions for Waiver of Section 64.702 of the Commission's Rules and Regulations, 100 FCC2d 1057 (1985); Amendment of Section 64.702 of the Commission's Rules and Regulations, CC Docket 85-229, FCC 86-252 (released June 16, 1986) ("Computer Inquiry III").

[3] Justice Report at 46.

[4] 552 F.Supp. at 195. In fact, the Court used a competitive cost-benefit analysis in reaching the conclusion that the restriction on marketing CPE which was contained in the proposed decree was not in the public interest. The Court pointed out that the BOCs are "more likely than any other competitive entity to provide an effective counterbalance to AT&T's market strength and thereby promote a genuinely competitive market."

[5] Comments of Geller et al. in Proposed Modified Decree, April 20, 1982 at 9.

[6] To some extent, the restrictions on BOC provision of information services may be protecting "phantom competitors" or those who vigorously argue before the Court that these restrictions are needed but who have provided little in the way of new services. For example, the newspaper publishers urged the Court to bar the BOCs and AT&T from engaging in electronic publishing and especially in providing "electronic yellow pages". Yet, with some exceptions, the newspapers have been unwilling to enter the electronic publishing market or have abandoned what few efforts were underway. This "market failure" may, in part, be attributable to a natural reluctance on the part of the publishers to jeopardize their monopoly status in print advertising (and especially in classified advertising). I strongly urge the avoidance of restrictions which amount to economic protectionism, in favor of a framework within which all can compete.

[7] AT&T's inauspicious debut in the computer market may have turned out differently had IBM not had a 30-year headstart, imposed in the name of promoting competition.

[8] See generally Computer Inquiry III.

[9] State regulatory bodies may also play an important regulatory role with respect to information services. In Computer Inquiry III, the FCC reaffirmed the states' jurisdiction over the rates to be charged for the unbundled network elements (referred to as "basic service elements" or "BSEs"). At the same time, the Commission preempted state regulation of the process of defining BSEs and of state interference with the overall scheme of Open Network Architecture. As a result of recent court challenges to the FCC's preemption authority, the exact nature and extent of the states' regulatory role remains to be clarified. However, I believe that the Congress and the Antitrust Court should proceed on the basis that enhanced services are not "common carrier" offerings under Title II of the Communications Act and are, therefore, subject to the preemptive authority of the Commission vis-a-vis state regulation. See Computer and Communications Industry Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied sub nom. Louisiana Public Service Commission v. U.S., 461 U.S. 938 (1983).

[10] I believe that there are economies of scope with the production of printed directories for both white and yellow pages.

[11] Justice Report at 151, n. 300.

[12] See 47 C.F.R. Sec. 68.1 et seq.

[13] Here again I believe that the FCC has the ability to prevent cross-subsidy. Further, there is great incentive on the part of both federal and state regulators to make certain that no manufacturing costs are included in the rate base.

[14] Justice Report at 69.

[15] This end-to-end competition is occurring primarily with satellite-based systems. For example, since 1982, all television distribution has shifted from the telephone network to satellite carriers. VSAT systems are being used increasingly for data networks by firms such as Southland and Walmart. In addition, private microwave systems are providing end-to-end networks and similar opportunities will be possible with fiber optic systems as the backbone technology.

[16] U.S. v. Western Elec. Co. Inc., 592 F.Supp. 846, 867 (D.D.C. 1984).

[18] Justice Report at 100.

[19] 552 F.Supp at 194-95.

[20] The MFJ has also brought about equal access much more rapidly than the regulatory process alone could have. It has complemented and accelerated the FCC's efforts to open monopoly markets to competition.

Henry Geller is now Director of the Washington Center for Public Policy Research, a part of Duke University. The above comments are based on his experience in the area, as General Counsel of the FCC (1964-70), Assistant to the Chairman of the FCC (1970-73), and Assistant Secretary of Commerce for Communications and Information (and NTIA head -- 1978-81). The comments represent disinterested views. I am not now, nor have I ever been, retained by any private entity in the communications field.

TELECOMMUNICATIONS POLICY TODAY:
Against Technology

Henry Geller

PROLOGUE: *For much of our nation's history, telecommunications technology remained relatively stable, and the telecommunications industry concentrated on providing basic telephone service at affordable rates. It was an era of predictable demand and pervasive regulation. Advances in the underlying technology have now brought a range of new customer demands for computerized equipment and services. The telecommunications marketplace is rich with entrepreneurial opportunities.*

It is also a marketplace where the rules of engagement are subject to sudden change by Congress, the federal courts, and the Federal Communications Commission (FCC). In recent months both Congress and the FCC have begun to reassess some of the restrictions imposed on the regional Bell telephone companies by the 1982 modified consent decree that led to the breakup of AT&T's Bell System.

In this essay Henry Geller, a former general counsel of the Federal Communications Commission, examines the changes that have recently occurred and argues that U.S. telecommunications policy has not kept pace with the technological changes. Unreasonable restrictions, he says, are barring major segments of the U.S. telecommunications industry from competing effectively in the domestic and international marketplace.

Henry Geller received a B.S. degree from the University of Michigan in 1943 and an LL.B. degree from Northwestern University in 1949. He served as general counsel of the Federal Communications Commission from 1964 to 1970 and as assistant secretary of commerce for communications and information from 1978 to 1981. He has written extensively on such topics as telephone deregulation and the fairness doctrine in broadcasting, and he currently serves as director of Duke University's Washington Center for Public Policy Research.

In a fast-changing field such as telecommunications, government policy must be consistent with the underlying technology; otherwise, it will do serious harm. Today the telecommunications policy of the U.S. government is at odds with the driving technology in major respects and should be drastically revised. The existing policy bars roughly one-half of the U.S. telecommunications industry from competing effectively with its rivals in the telecommunications and information services market, a lucrative, dynamic field whose size and importance cannot be overestimated. World sales of telecommunications hardware amounted to $60 billion in 1984. The annual domestic U.S. market for information services, including voice and data communications, is $115 billion and doubles every six years. Failure to change the government's restrictive policy will mean the loss of economic and social benefits to the nation. Major telecommunications companies that were once part of AT&T's Bell System will remain barred from competing effectively in both the domestic and world markets.

Before World War II U.S. telecommunications policy permitted and fostered a de facto telephone monopoly that was in full accord with the existing technology—a technology based upon a paired copper wire. Competition made little sense when the costs of duplicating the existing system to provide either local or long distance service were prohibitive. After World War II the technology changed drastically. First came the microwave, followed by the coaxial cable, and then satellites and fiber optics. A single satellite transponder can simultaneously carry six television shows, or 3,900 phone conversations. A single glass fiber can transmit the entire contents of the *Wall Street Journal* from New York to Washington in 10 seconds.

The computer has also now become an integral part of telecommunications. It has brought enormously greater speed and efficiency to switching—that essential process that routes both voice and data messages within and between communications networks. Packet switching—whereby data messages are broken down into smaller units and sent in rapid bursts—is dependent solely on the computer. The trend is clear; the telecommunications industry is moving from the analog form of representing information, so suited to voice transmission, to the digital form, which is able to handle both data and voice transmission. The data processing and telecommunications fields are coming together.

This merging can be readily seen in the equipment field. Private branch exchanges (PBXs)—private switchboards in company offices that receive and place telephone calls and connect interoffice extensions—are now computers. They can be used one moment for communications (switching phone calls) and the next moment for data processing. A private branch exchange can be purchased from a telephone company (AT&T) or from a computer company (IBM/Rolm). Furthermore, a local telephone company can offer Centrex service, in which the company's central office switch acts much like a private branch exchange, providing a subscriber with intercom and conference calling in addition to the usual outward-dialing service. The merging of computers and telecommunications can also be seen in protocol conversion, a data processing service that allows computers using different methods for handling information to converse with one another. This vital service can be performed in an office by equipment supplied by a company such as IBM; by a data processing service, such as GTE's Telenet; or by the local telephone network, which can act as a universal gateway for data transmission just as it does for voice transmission. The computer—the integrated circuit—now underlies the entire telecommunications information industry.

The governmental response to the changing technology was twofold. First, it broke up the existing telephone monopoly by forcing AT&T to divest itself of the Bell Operating Companies (BOCs). Second, it deregulated the telecommunications equipment business and permitted competition in telephone service. Thus, the telephone line is now like a power line; any equipment that meets certain technical specifications can be attached to the phone line. Competition in telecommunications now includes private microwave links; cellular radio services; digital termination systems that provide local, two-way transmission of digital messages by microwave radio; and cable television companies that offer data communications by way of coaxial cable to urban customers.

In addition, new companies can now enter the interstate toll field and offer, for example, voice and data communications services between major cities by way of microwave, satellite, or fiber-optic transmission lines. In short, the marketplace for sophisticated telecommunications equipment and services has become highly competitive. Success requires prompt and efficient use of the latest technology.

For years the established monopoly, AT&T, was the barrier to change in telecommunications policy. The company was huge and had assets greater than IBM and Exxon combined. With a guaranteed monopoly both in a substantial part of the nation's local phone business and in long distance toll service, AT&T could improperly cross-subsidize when it entered the new competitive telecommunications or information fields. That is to say, when the costs had to be assigned for facilities used jointly for both its monopoly services and the new competitive enterprises, there was a considerable possibility that AT&T would improperly assign more of the costs to the monopoly ratepayer, who had no other alternative than to pay what AT&T charged. By assigning such costs to the ratepayer, AT&T could readily subsidize its competitive services and underprice its rivals.

In response the Federal Communications Commission (FCC) in 1981 demanded that AT&T create fully separated subsidiaries for its competitive undertakings so that there would be no cross-subsidization. The Department of Justice, however, believed that much more was needed to ensure effective competition, particularly in the long distance toll area in which new competitors such as MCI, GTE Sprint, and SBS were entering the market. The department's answer was divestiture—forcing AT&T to spin off the local telephone monopolies that were the essential link between the new long distance toll competitors and the customers willing to buy their cheaper services. Without the help of the local phone companies, MCI and the others had no way to complete a toll call—to cover the so-called last mile. Divestiture, implemented in 1984, left intact AT&T Long Lines (now called AT&T Communications), the Western Electric manufacturing subsidiary (now AT&T Technologies), and the R&D subsidiary (AT&T Bell Laboratories). In the view of the Department of Justice, this arrangement separated what it termed the workably competitive (toll phone service and manufacturing) from the natural monopoly (the local exchanges).

It is critically important to recognize why AT&T acquiesced in the divestiture. Under a 1956 consent decree entered into with the Department of Justice, AT&T was allowed to provide only common carrier services, with the rates being subject to regulation. This was in accord with the compromise struck by Theodore Vail, president of AT&T, and the Department of Justice at the turn of the century—that AT&T would be a giant telephone monopoly subject to regulation to protect the public interest. But this arrangement was out of tune with the changing technology of telecommunications. AT&T now recognized that if it were to flourish it must be free to provide, on a deregulated basis, the new computerized information services that involve data processing. Thus, in explaining the rationale for accepting the Department of Justice's divestiture proposal, AT&T's counsel, George Saunders, stated, "The technology of telecommunications has so merged with the technology of data processing that if we end up with the 1956 consent decree we are a withering corporation waiting for its demise and nothing more—[the] Penn Central of the 90's."[1] In short, whereas railroads such as the Penn Central had gone broke because they failed to recognize that they were in the transportation business and had to become integrated with other modes of transportation, AT&T was determined to survive by recognizing that it was in the information business and not merely providing telephone service.

AT&T had to escape the straitjacket imposed by the 1956 consent decree. But the company's top officials also recognized that AT&T was simply too large—that it was impossible to move a huge regulated monopoly into the new competitive areas without being continually harassed by smaller competitors claiming foul play. It was politically impossible to obtain legislative relief from Congress to allow unregulated entry into the new information services businesses. AT&T had little choice but to turn reluctantly to the judicial sector to achieve its goal and to agree to Department of Justice demands that it divest itself of the local telephone operating companies. For "Ma Bell" this meant lopping off $112 billion (of $155 billion) in assets and creating seven regional holding companies to absorb the 22 Bell Operating Companies.

With one minor exception (it may not engage in electronic publishing over its own transmission facilities until at least August 1988), AT&T may now enter any field. Although it is still freeing itself from certain regulatory restraints, such as the FCC requirement that it create a separate subsidiary to sell data processing services and customer-premises equipment—equipment used to originate, route, or terminate telecommunications—AT&T is now in a position to compete with its rivals by offering faster, more efficient telecommunications and information services based on the latest technology. Thus, AT&T's future is closely tied to a dynamic technology. It is the divested BOCs whose future prospects are curtailed by inappropriate restrictions on their entry into the promising information services and customer-premises equipment manufacturing markets.

Under the 1982 decree entered by federal district court judge Harold H. Greene that modified the 1956 consent decree and broke up AT&T, the BOCs are greatly restricted in what they can undertake because they continue to control the essential local monopoly telecommunications pipelines. They cannot provide interexchange services—that is, service between two or more exchange areas (typically long distance telephone service). They also cannot offer information service, defined in the court ruling as "offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information which may be conveyed via telecommunications." Likewise, they are forbidden to manufacture customer-premises equipment or provide "any other product or service, except exchange telecommunications and exchange access service, that is not a natural monopoly service actually regulated by tariff."[2]

The ruling of the district court offered one modest concession with a proviso in Section VIII (C) that a BOC could enter a new line of business not specifically permitted in the court decree "upon a showing by the petitioning BOC that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter."[3]

But in an opinion issued July 26, 1984, Judge Greene made clear his position on waivers of the prohibitions against offering interexchange and information services and manufacturing of customer-premises equipment:

> The Court will not even consider the substantive merits of a waiver request seeking permission to provide interexchange services until such time as the Regional Holding Companies lose their bottleneck in local telecommunications service. . . .
>
> Similar considerations govern the appropriateness of entry of the Regional Holding Companies into the information services and equipment manufacturing markets. No significant technological or structural changes have occurred in these markets to justify a relaxation of these lines of business restrictions, and no requests for waivers in these markets will be considered unless and until such changes have taken place.[4]

The significant technological and structural changes to which Judge Greene referred would be the ending of the BOCs' monopoly position in local telecommunications services.

The BOCs cannot now be permitted to offer interexchange services within their service areas. At the least their entry into this line of business should wait until they are providing AT&T's toll competitors with equal technical access to the local exchange (now scheduled for September 1986) and have established a tradition of prompt, efficient, and impartial service to all the interexchange carriers. The significant flaw in the present government policy lies in its flat prohibition of BOC entry into the information services and customer-premises equipment manufacturing markets.

In assets and revenues the BOCs comprise more than one-half of the $350-billion U.S. telecommunications industry. They are large companies; the assets of the seven regional holding companies that own the 22 BOCs range from $16 billion to $23 billion. Like AT&T, the BOCs are driven by technological and competitive forces to enter the information (data processing) services market. They, too, want to avoid the fate of the U.S. railroads. Yet, under the terms of the 1982 decree and its subsequent strict interpretation by Judge Greene, they are absolutely barred from doing so. This policy clearly repeats the mistake of the 1956 consent decree, which sought to limit AT&T to the status of a regulated common carrier. It is a policy that consigns the BOCs to technological backwardness and rules out any near-term hope that they can participate fully and effectively in the national and international telecommunications and information services marketplace. It needlessly restricts BOC competition with AT&T and with other telephone companies, such as GTE.

Despite the fact that GTE is virtually identical to the BOCs in its basic functions, the district court that imposed restrictions on the BOCs has permitted GTE to continue offering information services with appropriate conditions to ensure fair competition—for example, by operating through a separate subsidiary. The effort to distinguish GTE from the BOCs is strained, to say the least. Like the BOCs, GTE has substantial assets and owns local telephone monopolies throughout the United States, including California, Florida, Pennsylvania, and Hawaii. Unlike the BOCs, GTE is also engaged in providing interexchange services and in customer-premises equipment manufacturing. It clearly serves the public interest to have GTE provide an innovative, competitive information service, such as Telenet, in Los Angeles and Tampa. Why is it not also in the interest of the public and fair competition to have a BOC provide a similar service in San Francisco or Miami subject to similar conditions?

The BOCs are under great pressure to provide these services. Both the technology and the market are available. Furthermore, the BOCs are ideally situated to enhance the efficiency and productivity of the nation's telecommunications system. For example, packet-network service vendors, such as Telenet, provide processing services that allow otherwise incompatible computer terminals on the network to communicate with one another. Essentially, the packet network provides enough data processing to translate from a specific nonstandard terminal to a standard terminal. This processing task is a natural part of any universal data network. Any prohibition of the BOCs from providing this service and similar ones as part of a local data communications network is inefficient; it limits the usefulness of the network.

In its determination to suppress the technologically driven efforts of the BOCs to compete, the 1982 decree has created ludicrous situations. For example, the BOCs wish to provide voice storage in their cellular radio operations and thus permit a customer with a mobile telephone in his car to receive messages stored in a BOC's central computer. But this would be a prohibited offering for the BOCs and one for which the court has announced that it will not entertain a waiver. The BOCs' competitors in the mobile phone market, however, can provide this and other enhanced services.

In 1984 the Department of Commerce twice urged the Department of Justice to support an easing of restrictions on the BOCs.[5] A letter from Assistant Secretary of Commerce David Markey to Assistant Attorney General Paul McGrath on October 1, 1984, stated that the national interest is not "furthered by placing needless, artificial restrictions on the activities of companies that constitute half the telecommunications industry, particularly given the rapid changes in technology characteristic of this industry. . . ." Markey pointed out that IBM has expanded into the customer premises equipment business through its $1 billion acquisition of Rolm Corporation, a major producer of computerized private branch exchanges. He also noted that both AT&T and GTE are engaged in telecommunications equipment manufacturing, as are several foreign firms such as Northern Telecom, Nippon Electric Company, Fujitsu, and Siemens. Said Markey: "We know of no sound communications policy reason to establish and perpetuate restrictions on the RBOCs (Regional Bell Operating Companies) which have as a direct and immediate consequence protecting these large U.S. corporations and foreign multinationals from competition with the RBOCs."

Markey's letter also noted that in 1984 the United States would have a $1 billion trade deficit in the telephone and telegraph equipment sector, and it concluded:

> From an overall trade policy standpoint . . . this obviously is not an appropriate time for Government to adopt and perpetuate policies that have the practical effect of warehousing half the resources of the American communications industry. Permitting the RBOCs much greater flexibility to offer new and competitive services will not necessarily solve immediately all of the problems the United States now confronts in this important trade sector. Such flexibility, however, would constitute an affirmative step in the right direction and could lead to a solution.

Without unrestricted BOC participation in the telecommunications services and equipment marketplace, recent worrisome trends are likely to worsen. The U.S. trade deficit in the telecommunications equipment sector in 1984 came to $608 million. Japanese companies alone are selling 20 times as much telecommunications equipment in this country as U.S. firms sell in Japan. The U.S. share of the entire international telecommunications equipment market fell from 15 percent to 13 percent between 1978 and 1983.

The Commerce Department's position makes good sense. The restrictions on manufacturing customer-premises equipment should be lifted so that the BOCs can compete, with appropriate safeguards, in this market. Without manufacturing facilities, the BOCs cannot reasonably be expected to engage substantially in the R&D that is vital to this dynamic sector.

It may be that some or most of the BOCs will not want to enter such a highly competitive market. But at a time when U.S. trade negotiators are pressing to open foreign markets to U.S. manufacturers to improve the U.S. balance of trade, it makes no sense for the U.S. government to deny entry into those markets to seven companies with extensive telecommunications experience. Nor do the restrictions make sense in light of the developing partnership between IBM and MCI. With its software and computer expertise, the hardware of Rolm, and the long distance data network of MCI, IBM is now positioned to offer sophisticated information services to large business customers worldwide. AT&T is moving in a similar direction. Yet the BOCs are immobilized in this critical respect.

The decree or ruling of the district court is not sacrosanct. Congress could establish a different policy and, indeed, should be the arbiter of such an important issue. Despite several concerted and good-faith efforts, however, Congress has been unable in the last decade to enact any legislation that would establish effective policy guidelines because of the clash of powerful contending industries, including telephone, cable, newspaper, and data processing. Although some powerful congressional leaders, such as Rep. John Dingell (D-Mich.), chairman of the House Energy and Commerce Committee, have criticized the decree provisions precisely because they restrict BOC activities, it seems unlikely that Congress will act anytime soon.[6]

In the Cable Communications Policy Act of 1984, the issue of competition between cable and telephone companies in the area of data communications arose. The phone companies argued for a "level playing field"—either regulate cable or deregulate both and let them compete equally for data communications business. Congress essentially left the issue to be resolved by the FCC and the courts under existing law. In my opinion Congress should have permitted the cable companies to compete in data communications on a deregulated basis and removed the inappropriate restrictions on the BOCs.

The Department of Justice—not AT&T—insisted that the BOCs be restricted in their activities; therefore, it is appropriate that the executive branch initiate the removal of these restrictions by convening an executive policy council meeting in which the issue can be resolved by the president. Telecommunications is an area of the greatest importance to the United States and fully warrants presidential attention.

If the matter is resolved along the lines suggested here, the Department of Justice would seek revision of the 1982 decree and give all the interested parties a chance to be heard. It is important to note that the FCC supports the removal of the restrictions.[7] If the White House does not direct the Department of Justice to move on this issue, the FCC, perhaps after receiving petitions from the BOCs and the Department of Commerce, could issue a declaratory ruling that the restrictions on information services and manufacturing are inconsistent with the Communications Act of 1934. With the issuance of such an FCC declaratory ruling, the BOCs could seek to have the 1982 decree modified on the grounds that it conflicts with Communications Act policy as delineated by the commission, and that under established law, the Communications Act is paramount in the event of a conflict.[8] If unsuccessful at the district court level, the BOCs could seek appellate review with the full support of the FCC as amicus curiae.

In sum, the restrictions imposed on the BOCs are clearly inconsistent with the national interest, the demands of the marketplace, and the underlying thrust of technological changes occurring in telecommunications. It took a generation to remedy the flawed policy imposed by the 1956 consent decree that made AT&T a regulated monopoly restricted to common carrier service. Surely we cannot afford to repeat that mistake by placing restrictions on one-half of an industry so vital to the United States. Telephone companies, cable entrepreneurs, and others entering this dynamic and merging field of telecommunications and computers must be allowed to introduce products and services on an equitable and competitive basis. ■

NOTES:

1. *U.S.* v. *AT&T*, 1982-1 Trade Cases 64, 465 at 72, 607 (D.C.C. 1982).
2. *U.S.* v. *AT&T*, 552 F. Supp. 131, 186–95 (D.D.C. 1982), modified (Aug. 24, 1982), aff'd sub. nom. *Maryland* v. *U.S.*, 460 U.S. 1001 (1983).
3. *U.S.* v. *AT&T*, 552 F. Supp. 195.
4. *U.S.* v. *Western Electric Co., Inc.*, 529 F. Supp. 846, 868 (D.D.C. 1984).
5. Letter from Secretary of Commerce Malcolm Baldridge to Solicitor General H. Rex Lee (April 6, 1984) and letter from Assistant Secretary of Commerce David Markey to Assistant Attorney General Paul McGrath (Oct. 1, 1984) on file in the Department of Commerce.
6. See *Communications Daily*, Feb. 14, 1985; letter of Rep. John D. Dingell to Attorney General Edwin Meese, dated Aug. 7, 1985, and reply of Sept. 19, 1985.
7. See Brief of the FCC as Amicus Curiae at Pt. III, 29–53 (D.D.C. 1982).
8. The essential ruling might also be made in a pending proceeding such as Computer Inquiry III, FCC Docket No. CC 85-229.

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James R. Young
General Attorney

April 30, 1987

The Honorable Howard M. Metzenbaum
Chairman, Subcommittee on Antitrust,
Monopolies and Business Rights,
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed is the testimony of Robert A. Levetown, Executive Vice President and General Counsel of Bell Atlantic Corporation, to be included in the record of the hearing which the Subcommittee is holding today on the telecommunications industry and the AT&T consent decree.

This is the same testimony which Mr. Levetown filed on April 27 before the Subcommittee on Monopolies and Commercial Law of the Committee on the Judiciary of the United States House of Representatives. Included are:

1. A one-page summary of Mr. Levetown's statement;
2. The full text of Mr. Levetown's statement on behalf of Bell Atlantic;
3. A brief outline of Mr. Levetown's professional background;
4. A copy of the Memorandum filed by Bell Atlantic on April 27, 1987, with the U.S. District Court which administers the AT&T consent decree.

This latter document is relevant to the subject matter of the Subcommittee's hearing because it relates to the restrictions in the decree which presently bar Bell Atlantic and the other divested telephone companies from providing various goods and services to the public.

Respectfully,

James R. Young

James R. Young

Enclosure

SUMMARY OF STATEMENT OF ROBERT A. LEVETOWN
EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL OF BELL ATLANTIC

The break-up of the Bell System has created an historic opportunity to increase competition in all aspects of telephony.

In the three years since divestiture, increased competition has quickly materialized, and the public has greatly benefitted, in those activities in which the divested Bell telephone companies have been permitted to participate. This is particularly true for those activities that are directly related to telephone service, such as the sale of telephone equipment and the provision of mobile telephone services. Prices have tumbled and innovative features have become rapidly available to the public.

In those telecommunications activities in which the telephone companies have not been permitted to fully participate, such as long distance service, the public benefits from divestiture have been much more questionable. AT&T still retains a dominant share of the market. The 30% rate decrease that AT&T claims for its long distance service was nearly all attributable to rate shifts. Costs formerly billed by the telephone companies to AT&T for inclusion in toll rates are now billed by the telephone companies directly to end users as flat rate additions to their monthly charges. The FCC has given good reasons to support this rate shift, but the point is that there is no 30% decrease in long distance rates that is attributable to long distance competition. If the Bell telephone companies could enter this market, there would be real price competition.

There are positive aspects to H.R. 2030 because it would permit the Bell telephone companies to compete in the manufacture of telecommunications equipment and the provision of information services, activities which are now barred to them by the Decree. The bill has a long list of conditions, however, that have been overtaken by events: the FCC has substantially accomplished everything with respect to information services that the bill directs the Commission to begin investigating as of March 1, 1988. If enacted in its present form, H.R. 2030 would unnecessarily delay the introduction of competition as well as the important benefits to the public that competition in these activities would bring.

Experience since divestiture demonstrates that the telephone companies, if permitted to participate in competitive ventures, will not neglect telephone service. Bell Atlantic is now engaged in many unregulated activities. At the same time, Bell Atlantic supplies a greater percentage of households with telephone service in its territories than ever before; local rates have not been increased since January 1, 1986 and no rate increases are pending or planned for 1987; and Bell Atlantic, like the other regional companies, has invested about $2 billion every year since divestiture to expand and improve local telephone service.

ROBERT A. LEVETOWN

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STATEMENT OF ROBERT A. LEVETOWN

EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL OF BELL ATLANTIC

before the

SUBCOMMITTEE ON MONOPOLIES AND COMMERCIAL LAW

of the

COMMITTEE ON THE JUDICIARY

of the

U.S. HOUSE OF REPRESENTATIVES

My name is Robert A. Levetown. I am the Executive Vice President and General Counsel of Bell Atlantic, a company that owns the Bell telephone companies operating in New Jersey, Delaware, Pennsylvania, West Virginia, Virginia, Maryland and Washington, D.C.

I am familiar with the litigation that resulted in the AT&T consent decree and I represent Bell Atlantic before the decree court in the continuing proceedings related to the decree.

On April 27, Bell Atlantic filed a Memorandum with Judge Greene, asking to lift most of the line of business restrictions that the decree imposes upon Bell Atlantic and the other former Bell System telephone companies. A copy of that Memorandum is attached to this statement.

Bell Atlantic's basic position is that competition in telecommunications, and in the economy generally, should be encouraged rather than forbidden. Competition in telecommunications has been shown to be effective in driving down costs and prices; it has also been effective in stimulating innovation and permitting customers a range of choices.

1. Universal Service and Competition

For many years, the issue in telecommunications was whether or not competition could be introduced into the industry without compromising important policy goals that have been established by Congress and the regulatory authorities. The most important of these goals was the Congressional purpose stated in the Communications Act of 1934 to make available "so far as possible, to all the people of the United States," efficient telephone service at reasonable charges. This objective is frequently referred to as the goal of universal service.

Any doubts about the compatibility of competition and universal service have now been laid to rest. There is now more competition in the telephone industry than ever before; there are now more households (and generally a greater percentage of households) with telephone service than ever before as well.

Bell Atlantic has taken steps to be sure that basic telephone service remains affordable. It has in place in every one of its jurisdiction a wide range of optional telephone services that can be tailored to meet the calling needs and economic circumstances of almost every consumer. The most economical of these services costs as little as $5.00 per month. Moreover, in cooperation with state and local officials, Bell Atlantic has instituted a number of lifeline plans which are even less expensive. Other Bell telephone companies have similar rate plans dedicated to keeping customers on their networks.

2. The AT&T Consent Decree And Its Provisions Governing Competition

In 1982, AT&T and the Department of Justice entered an agreement to settle the Department's antitrust suit that was then being tried before Judge Greene in the United States District Court for the District of Columbia. Under the terms of the agreement, AT&T's local telephone companies were to be divested; all telephone equipment on customers' premises owned by the telephone companies was to be transferred to AT&T; the Yellow Pages advertising business was also to be transferred to AT&T; and further, the telephone companies were to be forever foreclosed from entering any competitive business.

The telephone companies were specifically prohibited from manufacturing or selling any type of telephone equipment. They were also barred from providing most interexchange (long distance) services or any of a broad class of high-tech services known as "information services".

Judge Greene held a proceeding to obtain comments from interested parties on the terms of the proposed settlement. Very few commentators objected to the proposed divestiture. A number of intervenors, including the FCC, expressed grave reservations about the restrictions on the Bell telephone companies. Judge Greene also noted that these restrictions were anticompetitive. AT&T took no responsibility for the restrictions: its officers told the Court and Congress that the restrictions were "not our idea."

Judge Greene insisted that the decree contain a provision that would allow the Court to waive any of the restrictions that prohibited the telephone companies from entering other businesses. He also ruled that the restrictions on the telephone companies would be revisited after three years and, if necessary, every three years thereafter. AT&T and the Department accepted the agreement as amended and the decree was entered by the Court.*/

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*/ Judge Greene also required that the agreement be amended to permit the telephone companies to sell telephone equipment and to allow them to retain their Yellow Pages business.

The decree as entered, was principally designed to facilitate competition between the long distance carriers. However, it permitted competition between all vendors, including the Bell telephone companies, in the sale of telephones and other customer premises equipment. It also permitted the telephone companies to compete in the furnishing of certain other communications services, such as mobile (e.g., car telephone) services. Competition in Yellow Pages advertising was permitted as well. And, on a case by case basis, the Court could authorize the telephone companies to engage in other business activities where their participation would not impair competition.

On the other hand, the telephone companies remained barred from furnishing many long distance services, from manufacturing any type of telecommunications equipment, and from providing information services.

3. The First Three Years: Progress In Competition Under The Decree

Three years of experience has taught the following lesson: in those telecommunications activities in which the Bell telephone companies could participate, they have competed vigorously with themselves and with others and consumers have benefitted from sharply lower prices and a wider range of options; in those activities in which the telephone companies are barred from competing, the public benefits potentially available from the Bell System divestiture have not been fully realized.

The most spectacular illustration of the value of competition in telephony, and particularly competition in which the telephone companies are free to participate, has been provided by the experience in the telephone customer premise equipment market. The price of all customer premise equipment has been drastically reduced over this three-year period and the range of customer choice is at an all-time high. No monopoly profits are being earned by anyone in this business but the consuming public has reaped enormous benefits.

Similar improvement in price and quality has been noticeable in the provision of mobile telephone services. Again, in this activity, some Bell telephone companies are competing against other Bell companies as well as against independent vendors.

Yellow Pages advertising has also become an intensely competitive business. NYNEX and Southwestern Bell are publishing competing directories in major population centers in Bell Atlantic's territories. R.H. Donnelley is publishing competing directories throughout Bell Atlantic's Pennsylvania and Delaware territories. In many cases, these directories offer lower advertising rates and, in some instances, they claim new features.

By contrast, the telecommunications activities from which the Bell telephone companies have remained barred from participating have developed in ways that are disappointing.

(a) Interstate Long Distance Competition

AT&T contends that there is vigorous competition in the interstate long distance market and that rates have decreased 30% since divestiture. In fact, most of this decline in these toll rates has been the result of FCC directions to the telephone companies to bill to customers certain costs that were formerly billed to long distance carriers and had been passed on by them in toll charges. Bell Atlantic supported this FCC action. However, the point is that what has occurred here is a rate shift, not a rate reduction; and certainly it is not a rate reduction caused by competition among long distance carriers.

The questionable state of competition among these carriers is best exemplified by MCI's recent request to the FCC that the FCC deregulate AT&T. MCI obviously does not foresee vigorous price competition with AT&T. Rather, it apparently anticipates that if AT&T could maintain or increase its prices, free of regulatory oversight, MCI would be able to operate under AT&T's price umbrella.

This, however, is a prescription for monopoly profits, not true competition. Both MCI and AT&T, as well as the other smaller long distance carriers, are dead set against Bell telephone company participation in the interstate long distance market. Undoubtedly they feel that such participation would result in the same price competition that has characterized the telephone equipment market.

(b) Information Services Competition

Results have also been disappointing in the market for information services. No mass market for information services has developed in this country. In France, Japan and other industrialized nations where the telephone companies participate in the provision of information services, the mass market is growing rapidly and independent information service providers appear to be satisfied with the role of their telephone companies.

Here, in contrast, legal restrictions have barred the telephone companies from enhancing their networks to make such services available to the general public. Consequently, many such services are only available to large businesses or other institutions who can afford to buy their own telephone switching equipment for installation on their premises; such equipment, unlike the telephone company's public network, can incorporate information service features without legal restrictions.

Groups representing consumers and information service providers have recently made formal filings with Judge Greene asking that he remove the information services restriction in whole or part. The consumer groups are concerned that the continued prohibition will result in the indefinite delay in the availability of such services to the public at large; that this, in turn, will contribute to the evolution of a two-class society consisting of information service sophisticates, on the one hand, and high-tech illiterates on the other. Groups representing independent information service providers also point out that telephone company participation in these activities is essential to facilitate the economical and wide-spread availability of their services.

(c) Manufacturing Competition

Presently, the Bell telephone companies have been granted waivers that authorize them to manufacture and sell telecommunications equipment abroad. Bell Atlantic and the other telephone companies want authority to manufacture and sell in this country as well.

Some manufacturers do not oppose this relief. Others, and particularly AT&T, are strongly opposed to it. AT&T believes that, if the Bell telephone companies are free to manufacture telecommunications equipment, they will buy less of that equipment from AT&T.

The fact is that the telephone companies have a reason to rely less on AT&T as a supplier regardless of whether or not they are authorized to manufacture. The reason is that AT&T is not only a supplier; it is also a formidable competitor, particularly for large business customers. AT&T provides these customers with complete communications systems that substitute for most of the services that are or can be provided to them by the telephone companies. AT&T also sells all business users equipment that is competitive with telephone company services. To the extent the telephone companies continue to place heavy reliance on AT&T providing them with their equipment, they are dealing with a competitor who has the incentive to make available equipment to customers, for whom they all compete, on terms which disadvantage the telephone companies.

Despite these concerns, Bell Atlantic still buys a large portion of its new central office switching equipment from AT&T. Their equipment is quite good. With the industry being as competitive as it is, no telephone company can afford to buy inferior or overpriced equipment, regardless of its source.*/

4. The Standard Arguments Against The Telephone Companies Competing For The Provision of Additional Services

There are basically four standard arguments made by those who would restrict the provision of products or services by the telephone companies. These arguments are (a) the telephone companies will use their exchange revenues (and will obtain exchange rate increases, if necessary) to cross-subsidize their other businesses, thereby putting their non-telephone competitors at an unfair disadvantage; (b) that the telephone companies, by buying from their own affiliates, would foreclose certain markets to competition; (c) that the telephone companies have "bottleneck" control over their local exchanges through which long distance traffic must pass, and they could use this control to disadvantage the services of long distance competitors; and (d) if permitted to engage in other businesses, the telephone companies might neglect telephone service.

(a) The Cross-Subsidy Issue

Cross-subsidy theories depend on the existence of cost-plus regulation. The notion is that costs of unregulated ventures will be shifted to regulated activities and assigned to the basic service category which is relatively free of competition. Thereafter, so the argument goes, regulators will unwittingly permit such improperly shifted costs to cause basic rates to rise.

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*/ Nearly all of the Bell telephone companies are still largely dependent on AT&T for upgrades or additions to their existing central office switching equipment, much of which had been originally manufactured by AT&T.

If the telephone companies had any intent to cross-subsidize in this fashion, logically they should want to retain the present system of cost-plus regulation. In fact, however, they do not.

Bell Atlantic and many other telephone companies are in favor of regulatory reform plans that would give the telephone companies an opportunity to benefit from any improvements in their own efficiency. In return for this opportunity, the telephone companies are willing to freeze basic telephone rates for extended periods. This is not the strategy of companies who intend to cross-subsidize.

Even under the present system of regulation, the FCC has pointed out that basic exchange services are an unlikely source of subsidy. Historically, by regulatory design, basic rates have been subsidized by other services. Many of these other services are now subject to competition. Consequently, neither basic rates nor other telephone rates are available to finance losing ventures.

No business, moreover, has a rational incentive to engage in cross subsidy unless there is a realistic expectation that, by subsidizing a product or service, competing suppliers can be driven from the market. The antitrust courts have rejected theories of antitrust cross subsidy that are not based upon such proof. There is no realistic possibility that AT&T can be driven out of telecommunications manufacturing or the long distance market; nor is it credible that the telephone companies will be able to monopolize other lines of business in which they have little or no prior experience.

Under the foregoing circumstances, there is no incentive for a telephone company to cross-subsidize even if it were to be assumed, contrary to fact, that neither the federal nor state regulators would detect such improper cost shifting. Nor would the incentive exist even if it were further assumed -- also contrary to fact -- that basic rate increases based on such improperly shifted costs would promptly and automatically be granted. The telephone companies have no incentive to take on regulatory, political and legal risks simply to shift profits from one pocket to another. That's all they would be doing if, at the end of the process, they could not realistically expect to oust competitors from the subsidized market.

Moreover, the premise that local rate increases are automatic is not now and has never been true. And, the more competitive telephony has become, the less rates have risen. Everybody in the industry today realizes that successful providers of telecommunications services will have to cut costs not increase rates. Bell Atlantic has requested no general rate increases and received none since January 1, 1986. None are planned for this year either.

A fuller discussion of the cross-subsidy issue and the various fallacies inherent in the cross-subsidy arguments presented by the opponents of telephone company competition appears at pp. 15 to 21 of Bell Atlantic's attached Memorandum.

(b) The Foreclosure Issue

The foreclosure argument is generally relied upon by those manufacturers, such as AT&T, who claim that the telephone companies, if permitted to manufacture telephone equipment themselves, would only buy from themselves, thereby foreclosing the market to better or cheaper goods that are produced by others.

The premise of this argument is entirely absent to the extent equipment of the type sold to telephone customers is at issue. It is those customers, not the telephone companies, who will decide whether the equipment meets the price and feature standards of the marketplace. Unless a telephone company can produce better or cheaper customer premise telephone gear, there's no reason to produce it at all.

The argument is made, however, that market foreclosure remains a problem with respect to central office switching equipment which is purchased primarily by telephone companies rather than by the general public. The contention is that telephone companies would have the ability to purchase inferior equipment from affiliates and would do so simply because they were affiliates.

For reasons previously referred to, that is very unlikely. Bell Atlantic needs the best and most efficient equipment to remain a preferred communications supplier in an increasingly competitive industry. It is for this reason Bell Atlantic still buys AT&T equipment despite its misgivings about the long-term reliability of AT&T as a supplier in light of its incentives as a competitor.

In addition, it is a very costly undertaking to develop and build a central office switch. Even if Bell Atlantic bought all of its central office switches from an affiliated manufacturer, it could not support the product alone. Sales would have to be made to non-affiliated telephone companies if the manufacturing project is to be viable. If the switch could not meet the standards of the marketplace, such sales would not take place.

(c) The Bottleneck Issue

The premise of this argument is that long distance carriers can only obtain access to their customers by passing their traffic through local exchange "gateways" controlled by the telephone companies. It is argued that, at these "gateways", there arises a potential for discrimination which would become actual discrimination if the telephone companies were authorized to compete for long distance services.

Allegations based on this theory were at the heart of the government's antitrust suit against AT&T. The decree, therefore, specifically prohibits the telephone companies from engaging in such discrimination; it also requires that the telephone companies provide "equal access" connections to all long distance carriers.*/ The decree itself, therefore, provides an answer to "bottleneck" fears.

The premise of the bottleneck theory, moreover, does not apply to many large customers. Such customers have sufficient volumes of long distance traffic to make it economically feasible for them to by-pass telephone company facilities and set up direct communications links to their long distance carriers. These customers generate a very large share of total long distance traffic. With respect to these customers, the telephone companies cannot be said to have bottleneck control.

Nor can it be argued that the telephone companies have bottleneck control over long distance traffic originating in areas where they do not provide local telephone service. In those areas, they have no control over the local exchange facilities.

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*/ The decree required the telephone companies to convert their networks to provide "equal access" services, i.e., arrangements to permit customers of all long distance companies to make long distance calls by dialing "1" plus ten digits and to provide the long distance companies with various technical capabilities formerly available only to AT&T.

All of the regional companies met the decree deadline for converting one-third of their lines to equal access. Bell Atlantic presently has converted 84% of its lines and expects eventually to have all lines converted.

It is Bell Atlantic's position that the telephone companies should be permitted to participate in long distance competition for those services and in those areas where the bottleneck argument is not a significant issue. A much larger volume of long distance traffic would then be subject to true price competition.

(d) The Neglect Issue

It is untrue that the Bell telephone companies are not interested in the provision of local telephone service. Every year since divestiture, Bell Atlantic has invested approximately $2 billion to improve its local networks; the other telephone companies have invested comparable amounts. In Bell Atlantic, the quality of service is very high as measured not only by technical indicators but also by extensive and on-going customer satisfaction surveys.

It is ridiculous to assume that the telephone companies are interested in abandoning or phasing out their stake in their successful, multi-billion dollar exchange businesses. On the contrary, they want to be able to use this considerable investment to provide any service or capability for which there is a market. It is also in the nation's interest that these assets be made to be as productive as possible. The decree restrictions, however, stand in the way.

Absent these restrictions, Bell Atlantic would be dedicating more funds, not less, to the telephone network. It would be enhancing its network to provide valuable information services which presently are unavailable to the public and it would be making the incremental investment necessary to provide a price-competitive long distance alternative.

5. The Possible Impact On Competition Of The Current Triennial Review

The decree Court is presently engaged in the first triennial review of the line of business restrictions. Approximately 120 intervenors are participating in this proceeding, nearly all of whom filed initial comments on March 13. There will be additional opportunities for written comments to be filed on April 27, May 12 and May 22. The Court has reserved decision as to whether or not it will require oral argument.

The proceedings focus in part on a study prepared by the Department of Justice by an independent consultant, Dr. Peter Huber. This study, which was conducted over nearly a year, culminated in a printed report approximately 600 pages in length that was issued in January, 1987. The report gathers and analyzes extensive data on the state of competition in telecommunications. Broadly, it concludes that technology has made and will continue to make telecommunications more competitive.

The Huber Report was submitted to the Court by the Department along with the Department's own Report and Recommendation. The Department concluded that all of the line of business restrictions should be lifted with the exception of the interexchange restriction.

With respect to that restriction, the Department concluded that it should be partially removed to permit the telephone companies to provide long distance services outside of their territories. Inside of the territories, however, the restrictions would remain until the removal of all state barriers to entry which, to varying degrees in various states, now protect the telephone companies from local exchange competition.

Bell Atlantic thought this proposition was fair in concept. The principal refinement it has offered to the Court is the proposal that if any individual long distance service -- such as private line service -- should be freed of state barriers to competition, then the competition with respect to that service should begin immediately and it should not be necessary for all barriers to competition for all services to be first removed.

AT&T, however, was very displeased with the Department's proposal. It argued that whether or not legal barriers to exchange service competition were removed, the exchange network is a "natural monopoly" and no actual competition is possible.

This is precisely the argument AT&T used to make about long distance. It filed hundreds of pages of testimony, affidavits and legal pleadings in support of the theory that, as a matter of telephone engineering, no true competition for long distance traffic was possible. Neither the FCC nor Judge Greene ever accepted this argument. And now AT&T disavows it as well. AT&T contends, in fact, that there is sufficient long distance competition to permit AT&T to be fully deregulated.

Competition is not impossible either for long distance service or local service. It it were, Bell Atlantic would not want to provide long distance service; nor would competitors for the local exchange business be building competing facilities in many cities across the country. One such competitor is constructing a fiber optic network within the Washington Metropolitan Area that will be able to compete with Bell Atlantic's C&P Telephone Companies. That network begins in Rockville, goes through the heart of the downtown Washington business district, and continues on to Tysons Corner.

In the proceedings before Judge Greene, there are many participants who favor giving the telephone companies greater freedom from the decree restrictions. Even if Judge Greene were to agree, however, there are still regulatory requirements that would have to be satisfied. Bell Atlantic, for example, would not be able to provide information services without meeting the stringent requirements of the FCC designed to assure other information service providers comparable access to Bell Atlantic's network. The FCC has also stated that it would have to approve any entry into the interstate long distance business.

6. The Potential Impact On Competition of H.R. 2030

H.R. 2030 makes a positive contribution to the policy debate concerning competition in telecommunications in that it proposes the lifting of the manufacturing and information services restrictions in the decree. However, the bill also requires the FCC to begin a process of inquiry, effective March, 1988, that the FCC has already been engaged in for several years and which is now largely complete.

The various departments of government that the FCC is directed by the bill to consult regarding information services have expressed their views to the FCC in formal pleadings; the principles for comparable access to the telephone network have been thought through and prescribed by the FCC; and all the required findings proposed by the bill have been made by the FCC after extensive consideration of the views of all interested parties.

In short, H.R. 2030 has a good purpose but it needs updating before it could serve as a useful spur to competition. Bell Atlantic would be opposed to starting the clock over to require the FCC, beginning in 1988, to consider once again the very same issues it has already resolved.

CONCLUSION

The Department has recommended that the line of business restrictions in the AT&T consent decree be removed in major part. It has done so after three years of post-divestiture experience. During that period, it has become apparent that the competition authorized at divestiture has benefitted the public and has not resulted in the deterioration of telephone service or the impairment of universal service.

The Department's recommendations, together with the views, pro and con, of approximately 120 parties, are now before the Court. Given the volume of pleadings, a ruling from the Court probably cannot be expected before the Fall.

Bell Atlantic supports the Department's Recommendation. It also supports Congressional interest in the telecommunications industry. Our telecommunications capabilities are a unique national asset. The full utilization of that asset is an important public policy concern.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. WESTERN ELECTRIC COMPANY, INC., and AMERICAN TELEPHONE AND TELEGRAPH COMPANY, Defendants.	Civil Action No. 82-0192

MEMORANDUM OF BELL ATLANTIC IN SUPPORT OF MOTION TO REMOVE PORTIONS OF THE LINE OF BUSINESS RESTRICTIONS CONTAINED IN THE AT&T CONSENT DECREE

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April 27, 1987

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UNITED STATES DISTRICT COURT
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UNITED STATES OF AMERICA, Plaintiff, v. WESTERN ELECTRIC COMPANY, INC., and AMERICAN TELEPHONE AND TELEGRAPH COMPANY, Defendants.	Civil Action No. 82-0192

MEMORANDUM OF BELL ATLANTIC IN SUPPORT OF MOTION TO REMOVE PORTIONS OF THE LINE OF BUSINESS RESTRICTIONS CONTAINED IN THE AT&T CONSENT DECREE

In 1982, the Court courageously approved an historic antitrust settlement, thereby setting the stage for an enormous increase in competition in telecommunications.

The decree that was originally presented to the Court -- a document privately bargained between the Department of Justice and AT&T -- would have made that competition impossible. The proposed decree made no express provision for the Bell telephone companies to engage in any competitive business.

Furthermore, the agreement specifically prohibited the to-be divested Bell telephone companies from competing in AT&T's

major remaining lines of business: the manufacture of telecommunications equipment and the provision of most long distance services.

Publicly, AT&T took no responsibility for this aspect of the decree. Rather, it maintained that these restrictions were "not our idea." AT&T's officials repeated that statement to Congress, to the Court, to the FCC and to AT&T's shareholders. Obviously, these anticompetitive restrictions, according to AT&T, were not the inducement for it to agree to divestiture. Consequently, there is no "deal" between AT&T and the Department that the lifting of the restrictions would breach.

To its credit, this Court refused to adopt this agreement in the form it was originally presented which would have severely and permanently foreclosed competition in telecommunications. As the Court has pointed out many times, the stimulation of competition, rather than its foreclosure, was the advantage to be gained from divestiture. Consequently, the Court required that the decree be amended to permit the Bell telephone companies to engage in competitive sales of telephone equipment and Yellow Pages advertising. The Court also required that the decree include a provision for waivers which would allow the Bell telephone companies to enter any line of business in which their entry would not harm competition.

To date, more than one hundred such waivers have been granted. However, most have granted authority to engage in various nontelecommunications lines of business. Very few of the waivers have granted authority to engage in long distance services or information services in this country and, when granted, such relief has been very limited.

Here, then, is a paradox: the Court has accused the telephone companies of wanting to become conglomerates; however, it is the decree restrictions which are forcing the telephone companies to invest in projects other than investments to improve and extend their telephone networks. The telephone companies are interested in the telephone business: Bell Atlantic has invested an additional $2 billion every year since divestiture to improve telephone service. It is willing to make the additional investments necessary to provide sophisticated information services to its customers or to offer them competitive long distance services.

In areas related to telecommunications in which the decree has authorized the Bell telephone companies to participate, the resulting competition has resulted in great bargains to the American publics. The price of equipment, such as telephone sets and switchboards, has been slashed and innovative features have been rapidly made available. The same is true in the competition for mobile services.

Divestiture was a step into the unknown. Nobody could be sure how the event would affect the quality or price of telephone service. Under those circumstances, the Court was understandably reluctant to authorize additional changes in the status quo of the industry.

As the Court foresaw, however, experience after three years has provided a basis for a second look at the decree and an opportunity for further scrutiny of the line of business restrictions. The Court insisted upon this because, from the very beginning, the Court realized these restrictions were anticompetitive.

It is now clear that such restrictions are an unjustifiable obstacle to the introduction of further competition into telecommunications and should, in whole or major part, be removed.

Summary of Bell Atlantic's Position

The relief requested by Bell Atlantic in its accompanying motion[1] is consistent with the principles of the

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[1] Bell Atlantic asks that the restrictions in section II(D)(1) of the decree be removed to permit it to provide interLATA private network services and vendor coordination services, including interLATA consulting, to private network customers; also, that Bell Atlantic be given authority to provide 800/WATS services. In every case, however, Bell Atlantic's relief would be implemented in each of its LATAs or portion thereof only if and when comparable state barriers to entry for competitors were removed.

Bell Atlantic also requests immediate authority to provide interLATA mobile services within its region and all categories of interLATA service outside of its region.

Bell Atlantic further asks that the restrictions of sections II(D)(1) and (2) of the decree be removed to permit it to provide information services, to manufacture customer premise equipment (CPE), and to manufacture and provide telecommunications equipment.

Finally, Bell Atlantic asks that the section II(D)(3) "catchall" restriction be removed and that the existing waiver orders addressed to Bell Atlantic be vacated in order to eliminate the burdensome and inconsistent conditions those orders now contain.

Department's Report and Recommendation and is supported by the documentation and conclusions in the Huber Report[2/] that was commissioned by the Department and submitted to the Court on February 2, 1987. The relief requested also meets the section VIII(C) standard in that it does not pose any substantial risk of harm to competition in the markets Bell Atlantic seeks to enter.

The interexchange relief sought by Bell Atlantic poses no substantial risk of harm to competition because it has been carefully crafted to avoid any "bottleneck" concerns. Outside its region, Bell Atlantic has no control of the exchange network, much less bottleneck control. Inside its region, Bell Atlantic proposes to provide, first, a limited class of interLATA services to a relative handful of large customers who have ready competitive alternatives to Bell Atlantic's access services; and second, a limited class of services to business customers wherein competitors will have the equivalent of 100% equal access and will be at no dialing disadvantage to Bell Atlantic's services.

The information service relief sought by Bell Atlantic poses no substantial risk of harm to competition as shown by the fact that information service providers have hired lawyers and affirmatively petitioned this Court to remove or at least modify

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[2/] Dr. Peter W. Huber, The Geodesic Network, 1987 Report On Competition in the Telephone Industry (January, 1987).

the information service restrictions.[3] Consumer groups,[4] the FCC and state commissions,[5] and other carriers[6] have also cast their votes for relief, as has the Department of Commerce.[7] A common theme among these commentors is that the general public in this country, unlike the publics of other nations, is being deprived of useful, sophisticated services; in this country, these services have only been made available to the economically privileged. The restrictions, consequently, are contributing to the fears of policy-makers that the telecommunications revolution will produce two user classes -- the haves and the have nots -- information service sophisticates, on the one hand, and high-tech illiterates on the other.

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[3] Comments of Integrated Communication Systems, Inc. at 2-3; Comments of the Videotex Industry Association at 1-3; Comments of the Motion Picture Association of America, Inc. at 13-15; Comments of the Computer & Communications Industry Association at 18-21; Comments of United Press International at 3-6.

[4] Joint Comments of National Consumers League, Black Citizens for a Fair Media and the Council of Churches of New York City, the National Association of State Universities and Land Grant Colleges, Native American Public Broadcasting Consortium and the National Indian Youth Council, Office of Communications of the Church Federation of Greater Chicago, Consumer Interest Research Institute, Public Interest Computer Association and National Association for Better Broadcasting at 11-37.

[5] FCC Comments at 7-9; Michigan Public Service Commission Comments at 4-5; Minnesota Public Utilities Commission Comments at 2; Virginia State Corporation Commission Comments at 1-2; West Virginia Public Service Commission Comments at 8.

[6] United States Telephone Association Comments at 8; Rural Telephone Coalition Comments at 6-8.

[7] United States Department of Commerce, National Telecommunications and Information Administration, NTIA Trade Report: Assessing the Effects of Changing the AT&T Antitrust Consent Decree (Feb. 4, 1987).

First amendment considerations also militate in favor of information service relief. The FCC has now created an elaborate set of regulatory mechanisms -- concurred in if not inspired by the Department -- for the very purpose of assuring telephone network access to all information providers. The FCC program goes even beyond the "information access" required by the Decree itself. Under these circumstances, there is a heavy and undischargeable burden on those who would continue to deny Bell Atlantic's first amendment right to publish. The theory that an electronic gag rule of this type is necessary to facilitate electronic publishing by others is a premise that is not only legally unsound, but it is also a theory which has been proven to be factually incorrect by experience abroad.

The manufacturing relief sought by Bell Atlantic poses no substantial risk of harm to competition, as demonstrated by the pleadings of various manufacturers who support the lifting of the restriction.8/ There is no possibility that Bell

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8/ A number of manufacturers support the complete removal of the manufacturing restriction. See Comments of Ericcson North American at 4-7; Comments of Stantel at 1-2; Comments of Novell at 7-16; Comments of Verilink at 5-6. Other manufacturers ask that the restriction be lifted in part so that the BOCs could manufacture customer premises and similar equipment. See Comments of the Computer and Communications Industry Association at 21-23.

Atlantic could foreclose the market for CPE. Most CPE must be sold to the general public in a wide-open competition where foreign suppliers play a substantial and increasing role.[9] The same rationale supports Bell Atlantic's request to manufacture various CPE-like devices which may be used either on a customer's premises or in Bell Atlantic's central offices. This equipment is similar if not identical to equipment produced for a wide variety of other purposes and thus presents no realistic opportunity for any significant market foreclosure.[10]

Even central office equipment itself cannot successfully be built and sold on a market foreclosure strategy -- the costs of development and production are so high that the only successful switch manufacturers are producers whose markets exceed those of any single regional company.[11] Any such central office equipment that may be manufactured by a regional company would, therefore, have to meet the test of successful sales to third parties - a test similar to that prescribed by this Court for waivered sales of software by a regional company to its own operating companies.[12]

9/ NTIA Trade Report at 36-44.

10/ Huber Report at 14.17; Table CO.11a.

11/ Huber Report at 14.13 - 14.15.

12/ E.g., Order ¶ G (Aug. 14, 1985) (Bell Atlantic waiver).

There is no realistic possibility that the regionals, if permitted to manufacture, could manipulate network standards to benefit their manufacturing operations. Neither AT&T nor GTE has achieved that result; there is no reason to believe that the regionals could accomplish it. Nor would this be a rational objective: manufacturing efficiencies are captured through large production runs; to maximize production, the equipment must be marketable anywhere; high levels of profits cannot be produced by custom manufacturing to idiosyncratic specifications for regional "boutiques."

The removal of the "catchall" restriction sought by Bell Atlantic poses no substantial threat to competition as shown by the fact that, since divestiture, over 100 waivers have been granted by the Court for nontelecommunications lines of businesses; none, in fact, has been denied by the Court. The restriction was originally based on the "quarantine" theory, _i.e._, the notion that because the BOCs had "monopoly power" over exchange service, they should be barred from any other line of business. The Court never accepted this theory. The Department abandoned it when it recommended the first line of business waiver in 1984.

None of the relief now requested by Bell Atlantic, and none of Bell Atlantic's existing waivers, should be subject to the elaborate and inconsistent conditions that have been engrafted upon them through the current waiver process.[13] Provision of network services, such as interLATA services and information services, should not be subject to any conditions at all, and especially not to separate subsidiary requirements which would kill them in their cradle.

If, contrary to the Department's Report and Recommendation, the Court concludes that manufacturing and nontelecommunications activities must be housed in corporate entities other than the telephone companies, a consistent set of generic conditions should be prescribed to cover all such activities. Such conditions should apply as well to existing waivered activities.

In particular, however, the current 10% net revenue cap condition should be removed. The 10% restriction was not originally proposed by the Department, any party or intervenor. Consequently, its merits were never ventilated through the pleading process. The impact of this cap on the various regions is uneven, depending upon the nature of their nontelephone activities.[14] Furthermore, the economic consequences of the restriction are counterproductive to the purposes of the Court even assuming those purposes, which appear to be regulatory in nature, were appropriate matters of concern under the terms of the Decree.[15]

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[13] As explained more fully in Bell Atlantic's March 13 pleading, the current waiver process, which has no time limits and essentially affords no appeal from the Department's inaction, is a process in which the Department holds all the cards. As arbiter of the waiver process, the Department seeks to accommodate the objectors. Consequently, depending on who the objectors are to any particular waiver, and depending on how fanciful their notions of competitive harm may be, the BOC seeking the waiver is coerced to accept additional conditions in order to obtain the Department's approval. The net result of this process is a set of waiver conditions that are unnecessary to protect competition but were necessary to placate particular competitors. These conditions are in some cases inconsistent from waiver to waiver and frequently devoid of economic logic.

I. THE BASIC ARGUMENTS OF AT&T AND OTHER OPPONENTS OF INCREASED COMPETITION HAVE BEEN DISPROVEN BY EVENTS.

Twenty years ago, telephony was almost a total monopoly of AT&T. Over the years, as competition was introduced in incremental stages, AT&T always opposed it and always predicted dire results for the future of telephone service if competition were allowed.

It is not unexpected, therefore, that AT&T would continue to oppose additional competition in the two areas in which it retains market dominance: interexchange service and telecommunications manufacturing. This time, the dire threat to the future of telephony allegedly revolves around Bellcore.

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[14] Bell Atlantic Comments Concerning the Report and Recommendations of the Department of Justice at 30-33 (March 13, 1987) (hereafter "Bell Atlantic Comments").

[15] Id.

A. Competition Poses No Threat to the Functioning of Bellcore or to the Quality of Local Telephone Service.

AT&T claims that the "standard setting and equipment testing functions of Bellcore that the Court deemed so essential" would be substantially weakened if the BOCs were allowed to manufacture, in turn leading to "balkanized" regional network standards, and "threaten[ing] the Decree's goal of maintaining the quality and uniformity of the national telecommunications network."[16/]

Bellcore, however, does not set network standards. Instead, standards are now set domestically by an open industry forum, established in 1984 under FCC auspices, called T1. This group is open to all interested industry groups, including exchange carriers, interexchange carriers, manufacturers, and customers, and no BOC or group of BOCs can control it. Standard setting requires a two-thirds vote, and all the BOCs and Bellcore together constitute only 8 percent of T1.

Furthermore, even if Bellcore could torpedo the standard-setting process, manufacturing relief for the BOCs would not lead to any network "balkanization." Any BOC-manufactured equipment would have to be able to interact with the large embedded base of customer premises equipment manufactured by others, and equipment, manufactured by others

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[16/] AT&T Comments at 106-07.

such as AT&T, already in the BOCs' networks. The requirement for network compatibility strongly militates against the production of any equipment with unique standards.

There is also no reason to believe AT&T's claims that Bellcore's equipment testing efforts would become biased in favor of BOC-affiliated manufacturers. Bell Atlantic, for example, is not going to tolerate Bellcore overlooking faults in equipment made by NYNEX -- faults that will cost Bell Atlantic money or make its services less competitive. NYNEX, logically, would have the same attitude about equipment manufactured by Bell Atlantic. Precisely because Bellcore has multiple, independent owners, the Bellcore behavior predicted by AT&T is highly unlikely.[17]

B. Competition Poses No Threat to the Consuming Public.

It is also not surprising that other long distance carriers and some (but not all) of the telecommunications manufacturers, would take a position against competition similar to AT&T's. The fact is that the only consistent winner from increased competition is the consuming public. And the public has won - and won big - from the competition already authorized by the Court.

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[17] The United States Telecommunications Suppliers Association observes that, when Bellcore evaluates equipment, it receives proprietary information from the manufacturer. If the BOCs are permitted to manufacture, USTSA claims, they would have access to this proprietary information. USTSA Comments at 24. These concerns should not stand in the way of manufacturing relief. Instead, procedures for limiting information flow within Bellcore could be employed so that the potential harm which USTSA describes does not occur.

The most spectacular public benefits were produced by CPE competition. Despite stubborn resistance from the original parties to the decree and from many intervenors, the Court resolutely insisted that the decree be modified to permit the BOCs to enter the CPE market.

In the three years that have now transpired, the alleged BOC abuses have not materialized but the public has reaped enormous dividends from the Court-ordered competition: CPE prices have been slashed and customer choice of features and options has greatly increased.[18] CPE suppliers, including the BOCs, have not made a great deal of money in this competition but that was because monopoly profits could no longer be earned.

C. Competition Poses No Threat of Collusion Among the BOCs.

There has been no "collusion" among the BOCs in CPE sales - just as their has been no collusion in Yellow Pages advertising competition, another activity sanctioned by the Court over the objection of the original parties to the Decree. Today, for example, two regional companies, NYNEX and Southwestern Bell, are competing head to head with Bell Atlantic in major population centers in Bell Atlantic's territory. A similar pattern of vigorous inter-BOC competition is apparent in other activities, such as paging and mobile services.

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[18] Huber Report at 17.1; National Telecommunications and Information Administration, U.S. Department of Commerce, NTIA Special Publication 85-17, NTIA Competition Benefits Report at 11 (1985).

The BOCs are all highly independent and competitive organizations. They are rivalrous siblings, each of whom intends to outperform the others. Not only will they not cooperate in the marketplace whenever they have the opportunity to compete, but they can rarely even bring themselves to cooperate on joint pleadings to be filed with this Court - despite this Court's repeated requests that such joint pleadings be filed.

Given the history of inter-BOC competition since divestiture, it is nothing short of outrageous that unfounded speculation about possible collusion among the BOCs is still offered by some intervenors as a reason to deny the BOCs the opportunity to compete. Such speculation deserves no weight whatsoever in this Court's deliberations.

D. Competition Should Not Be Thwarted By Fallacious Notions of Cross-Subsidy.

Nearly every one of the 100 or more section VIII(C) waivers that has been granted by the Court has been opposed by some competitor who has alleged that BOC competition would create an unmanageable problem of unfair cross-subsidy. These claims were made with special vehemence when the Court was considering the advisability of allowing the BOCs to enter the

CPE business.[19] Had the Court been impressed by such rhetoric, the public would never have received the extensive benefits of that competition.

The claims of potential cross-subsidy, moreover, are based on propositions that are obviously and demonstrably incorrect. These propositions are as follows: (1) that telephone companies, unlike other business enterprises, have an incentive to lose money on a continuing basis on particular products and services even where there is no realistic opportunity to drive well-entrenched competitors out of the market; (2) that costs improperly shifted to telephone operations cannot be detected by federal or state regulators, or by independent auditors, and that local rate increases will automatically be permitted on the basis of such improperly shifted costs; and (3) that it is somehow unfair to permit the customers of the BOCs, unlike the customers of other large businesses with dominant positions in particular markets, to benefit from the savings attributable to their suppliers' size and scale.

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[19] In opposing BOC provision of CPE, the Department noted that "the FCC struggled for more than 20 years unsuccessfully to solve the problem of allocating common costs between competitive and non-competitive services. This very same problem would confront regulators if the BOCs were permitted to engage in competitive lines of business." Response of the United States to Public Comments on Proposed Modification of Final Judgment, at 57-58 (May 20, 1982). Likewise, NATA urged the Court not to permit the BOCs to market CPE in order "to interdict the abusive practices and cross-subsidies that occur and eliminate the incentives that fuel them." Comments of the North American Telephone Association in Support of Immediate Approval of Proposed Modification and Settlement at 20 (Apr. 20, 1982).

1. The Fallacious Belief in the Attractiveness of Perpetual Losses.

The BOCs are in the business to make money, not to lose it. In this regard, they are like any other profit-seeking organization.

This Circuit and the Supreme Court have repeatedly rejected antitrust theories based upon the supposed incentives of businesses to pour money into a perpetual black hole of losses.[20] Unless the BOCs could substantially and permanently lessen competition in a particular field, there is no rational basis for a policy of cross subsidy even if it were to be assumed that improperly shifted costs could be recouped by increases in basic telephone rates.

There is no motive for management to shift profits from one pocket to the other and to shoulder thereby significant regulatory risks and antitrust liabilities unless, at the end of the process, there is a realistic expectation of being able to dominate the cross-subsidized market. In none of the activities that are at the heart of the present controversy - and especially not for interexchange services or telecommunications manufacturing - is such an expectation realistic. It is even less realistic with respect to information services and nontelecommunications activities in which the BOCs have little or no prior experience.

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[20] Cargill, Inc. v. Monfort of Colorado, Inc., 107 S. Ct. 484, 494 n.15 (1986); Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 106 S. Ct. 1348, 1357-62 (1986); Southern Pacific Communications Co. v. AT&T, 740 F.2d 980, 1003 n.26, 1006-07 (D.C. Cir. 1984).

2. The Fallacious Belief in the Availability of Automatic Rate Increases.

Telephone rate increases, and particularly increases in rates for basic exchange services, are not and have never been automatically granted in the telephone industry.[21] Long delays, sometimes exceeding a year, attend the rate case process and any increases in the rates for basic service are highly controversial and politically explosive. Therefore, even assuming that competitive costs - despite the best efforts of auditors and regulators, including the elaborate rules now promulgated by the FCC - could be shifted improperly to basic telephone services, it would be a gross miscalculation for telephone company management to assume that the rates for such services would promptly or automatically increase.

The actual experience since 1985, when the BOCs began entering competitive lines of business pursuant to the authorization of the Court, is that telephone rate increases, and especially basic rate increases, have sharply declined. This is a reflection of the fact that all phases of telephony have become more competitive and telephone companies have realized that they must cut costs, not raise rates. Bell Atlantic has no general rate increases planned for this year, and received none since the beginning of 1986.

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[21] The difficulty of obtaining such rate increases was described to this Court in the testimony of AT&T witness Richard R. Hough at 24-43 (DT-124).

Furthermore, many of the BOCs, including Bell Atlantic, are in favor of regulatory reform plans that would largely eliminate cost-plus regulation. A multi-year moratorium on basic rates is generally a feature of such plans. These are not programs that companies intent on cross-subsidization through basic rate increases would support.

3. The Fallacious Belief That Economies of Scale and Scope Constitute Cross-Subsidy.

Like most other businesses, telephone companies derive efficiencies from economies of scope and scale. If sharing of facilities, personnel and corporate infrastructure were to be condemned as cross-subsidy, the public would be deprived of the primary benefits that large companies can offer them as consumers.

The antitrust laws do not condemn efficiencies of scope and scale or handicap competitors because they have such efficiencies. It is well settled that "a large firm does not violate [the antitrust laws] simply by reaping the competitive rewards attributable to its efficient size, nor does an integrated business offend the Sherman Act whenever one of its departments benefits from association with a division possessing a monopoly in its own market."[22] These efficiencies recognized by the Berkey court -- "more efficient production, greater ability to develop complementary products, reduced transaction costs, and so forth"[23] -- are precisely the economies which the opponents would deny to Bell Atlantic and to the consumers that Bell Atlantic serves.

The comments of TelCor America Corporation are illustrative. It claims that, in providing information services, the BOCs would have an unfair advantage because they could bill for information services using their existing billing systems, and the incremental costs incurred in the process would be minimal. Other information service providers, it claims, would not have this advantage.[24]

This, however, is no proof of anticompetitive conduct. It is simply an example of the ways in which BOCs could provide service more efficiently.[25] Their information service competitors have similar advantages. For example, nobody contends that it would be unfair if publishers use the same news gathering staffs for both print and electronic publications; nor does anyone claim that IBM should not use the same account executives to sell information services, computers, Rolm PBXs and MCI communications services.

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[22] Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 276 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980). Nor do the antitrust laws require a different test of cross subsidy when the company in question is a regulated utility in part of its business. Northeastern Tel. Co. v. American Tel. & Tel. Co., 651 F.2d 76, 90 (2d Cir. 1981), cert. denied, 455 U.S. 943 (1982); American Tel. & Tel. Co. v. FCC, 602 F.2d 401, 410 n.49 (D.C. Cir. 1979).

[23] Berkey at 276.

[24] Comments of TelCor America at 16.

Competitors have no incentive to permit the telephone companies to offer goods and services to the public that are priced on either incremental costs or shared costs. The public's gain is their loss. However, this Court has considered and rejected the notion that sharing of personnel and facilities for multiple services provided by the BOCs automatically constitutes cross-subsidy.[26]

The possibility of such sharing does not, therefore, present a basis for denying any of the relief requested by Bell Atlantic -- including relief from the patchwork of idiosyncratic conditions in Bell Atlantic's existing waivers.

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[25] If, for example, solely to avoid allegations of cross-subsidy, the telephone companies were required to build two networks - one for business services and another for residence service - telephone service for all classes of users would become much more expensive.

[26] The Department of Justice, right after divestiture, argued that no personnel or facilities should be shared between waivered activities and exchange operations. The Court rejected this proposal. United States v. Western Elec. Co., 592 F. Supp. 846, 872 & n.110 (D.D.C. 1984), appeal dismissed, 777 F.2d 23 (D.C. Cir. 1985).

E. Competition Should Not Be Thwarted by Fanciful Theories of Possible Network Discrimination.

Opponents of BOC entry into the CPE business prophesized that the BOCs would resurrect all the evils of discriminatory access the decree was designed to stop. Commentors warned that the BOCs had the incentive and ability to discriminate and that regulators would be incapable of preventing abuses in an evolving technological environment. Worse, even if monitoring of the technical aspects of interconnection were possible, the BOCs could still discriminate in "more subtle" ways, such as the untimely provision of maintenance, testing and restoration of facilities.[27] During the three years in which the BOCs have participated in the CPE business, these abuses have failed to materialize.

Similar theories of network discrimination have been rejected by the Court in granting waivers since the decree was entered. For example, in opposing Bell Atlantic's computer maintenance waiver requests, TRW asserted that the BOCs could disadvantage other providers of computer maintenance services by manipulating the quality of exchange diagnostic services, by lack of installation responsiveness and by withholding technical information to favor their own computer affiliates.[28] However, no competitor has complained of any actual interference or discrimination in telephone service since Bell Atlantic entered the computer maintenance market.

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[27] Response of the United States to Public Comments on Proposed Modification of Final Judgment at 58 (May 20, 1982).

The March 13 pleadings filed with the Court contain these same sorts of implausible discrimination theories. For example, AT&T suggests that BOCs would discriminate in the provision of private line services to interexchange competitors.[29] These, however, are "plain vanilla" facilities which involve none of the sophisticated signalling and processing capabilities used in the completion of an ordinary long distance call.[30] The simplicity of these private line services alone substantially reduces the risk of discrimination.

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[28] United States v. American Tel. & Tel. Co., 604 F. Supp. 256, 265 (D.D.C. 1984); Comments By TRW, Inc. In Opposition To Proposed Waiver of Section II(D) Of The MFJ To Permit Bell Atlantic To Enter The Computer Sales and Service Business at 7-12 (Oct. 24, 1984).

The Court has also granted other waivers in spite of competitors' predictions of future discrimination. E.g. foreign manufacturing (Order (June 26, 1986)) approved over NATA's claim that if a BOC manufactured CPE overseas, its customers would try to import that equipment in violation of the terms of the waiver order to get more favorable interconnection with the BOC (Partial Opposition of the North American Telecommunications Association to the United States' Motion for a Waiver Regarding Ameritech Foreign Business Ventures at 6 (June 11, 1986); advertising waiver (Order Apr. 13, 1987) approved over claims that the BOC would have incentive and opportunity to discriminate against competing advertising agencies if BOC facilities could be used to deliver advertising copy (Letter from Michael Yourshaw, attorney for ANPA, to Kevin R. Sullivan, Department of Justice, dated Oct. 21, 1985, at 3).

[29] AT&T Comments at 54-55.

Any degradation in the quality of a BOC private line provided to an interexchange carrier, moreover, would have to be so obvious that the interexchange carrier's ultimate customer would notice the difference. Otherwise, the discrimination would serve no purpose. At the same time, the discrimination would have to be so subtle that the interexchange carrier -- for example, AT&T or MCI -- would not notice and complain. Obviously, no "degradation strategy" could meet both objectives.[31]

In addition, if a BOC provided inferior private line service, the interexchange carrier could simply bypass the BOC. The Huber Report documents the extensive bypass alternatives to BOC private lines.[32]

Finally, some electronic database providers claim that, if the information services restriction were lifted, they would be vulnerable to BOC manipulation of "dial-up access" services. This dial-up service, however, is simply an ordinary local exchange call made by a database customer to a specialized carrier -- generally a Value Added Network ("VAN") -- which in turn connects the customer to the database. As the Huber Report notes, there is no opportunity for selective manipulation here:

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[30] Huber Report at 3.39.

[31] AT&T also suggests that BOCs could delay private line installation or provide poor maintenance to their interexchange competitors; AT&T even implies that such BOC behavior led to the private line provisioning problem in early 1984. AT&T's Comments at 55. However, the Department found that this problem was caused by "the complexity of the ordering process" and the "lack of familiarity" of both AT&T and the BOCs with the new procedures that had to be supplemented, for the first time, after divestiture. Letter from Jeffrey Blumenfeld, Department of Justice, to Richard C. Schramm, Bell Atlantic, dated June 18, 1984, at 1.

[32] Huber Report at 2.13-2.18.

> [T]he link here is precisely the same as the one LECs provide to users of voice services, and the data traffic is in fact an indistinguishable trickle in a river [of] traffic.[33]

II. EXPERIENCE UNDER THE DECREE HAS CAUSED THE DEPARTMENT TO CHANGE ITS POSITION ON THE NECESSITY FOR THE LINE OF BUSINESS RESTRICTIONS; SELF INTEREST HAS CAUSED AT&T TO CHANGE ITS POSITION TOO.

AT&T faults the Department for changing its views about the line of business restrictions and for arguing different positions now than it argued when the Decree was originally presented. The Department now has the benefit of three years of hindsight and experience under the Decree. It is not improper for the Department to base its views on the record of events since divestiture rather than on the stale trial record of events in the 60's and 70's which occurred under a entirely different industry structure.

AT&T, moreover, has also changed its position on key issues. The difference is that AT&T's change of position is based on its desire to assure its dominance in the long-distance and telecommunications equipment manufacturing markets, the only line of business restrictions that AT&T insists the "public interest" still requires. Further, while AT&T has changed its position and argued different propositions to this Court then and now, it is presently also arguing inconsistent propositions to this Court and to the regulatory authorities.

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[33] Huber Report at 5.14.

A. AT&T's Past Positions Before This Court Conflict With Its Present Position About the Alleged Monopoly Characteristics of Telephone Networks.

1. AT&T Used To Claim Long Distance Service Is a Natural Monopoly; Now It Contends It's Fully Competitive.

AT&T presented to this Court, and before that to the FCC, literally hundreds of pages of testimony, proffers of proof and pleadings dedicated to the proposition that the long distance network is a natural monopoly.[34] AT&T contended that because of the scope, scale and ubiquity of its network, it was an immutable rule of telephone engineering that no true competition could ever exist for interexchange traffic.[35] Neither this Court nor the FCC ever accepted that argument.

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[34] *See*, *e.g.*, the testimony of James N. Rosse (DT-119); Richard R. Hough (DT-124); Otto Eckstein (DT-250); Robert Olley (DT-130); Ronald A. Skoog (DT-117); and L.R. Christensen (DT-128); Economic Implications and Interrelationships Arising From Policies and Practices Relating to Customer Interconnection, Jurisdictional Separations and Rate Structures, 61 F.C.C. 2d 766, 785-86 (1976).

[35] Testimony of James N. Rosse at 75 (DT-119).

AT&T now disavows it as well. In fact, AT&T contends that interexchange competition is alive and well - so vigorous, indeed, that AT&T argues that it should be completely deregulated by the FCC.[36]

2. AT&T Does Not Apply the Same Economic Criteria To Exchange Service That It Routinely Uses to Demonstrate the Competitiveness of Long Distance Service.

AT&T has not retired the "natural monopoly" argument; it has simply reassigned it to the BOCs. It now argues that the Court should accept the very same argument, based on the same telephone engineering principles, applied to exchange service.[37] Thus AT&T contends that, whether or not state barriers to entry are removed in the intraLATA markets, these markets will inevitably remain natural monopolies.[38]

Yet, as the Huber Report documents, where exchange competition has been permitted by law, it has flourished. There are private switches now in place that substitute for 30 million lines that would otherwise be switched by telephone central offices.[39] The capacity of private microwave systems has grown from 270,000 voice grade circuits in 1982 to 3,400,000 in 1986, an increase of more than 1100 percent, and the growth of private fiber optic systems is even more dramatic.[40] In fact, one of those systems is operating today under the streets of Washington, D.C. These systems can be substituted for telephone company access lines, tie lines and other exchange services.

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[36] *See, e.g.*, Comments of AT&T, In the Matter of Decreased Regulation of Certain Basic Telecommunications Services, FCC Common Carrier Docket No. 86-421 (March 6, 1987).

[37] AT&T Comments at 45-52.

[38] AT&T Comments at 52-57.

[39] Huber Report at 2.6.

While it is true that the BOCs still retain the preponderant share of exchange revenues, AT&T has repeatedly told this Court and the regulatory authorities that static market share cannot be used to judge the competitiveness of a market.[41] Instead, AT&T has pointed to other factors, such as the growth in the number of competitors, and the growth in the capacity of the competitors' networks, as more accurate indicators of the state of competition. These same measures, when applied to the local exchange market, prove that no natural monopoly exists.

3. AT&T Argues to This Court That ByPass Is Not Practical; It Has Told the Regulatory Authorities That ByPass Is a Clear and Present Danger; And It Has Told Its Customers That ByPass Systems Are a Great Bargain.

In the present case, it is in AT&T's interest to argue that the potential for bypass of the exchange network is minimal. This preserves the bottleneck myth and protects AT&T's dominant position in the interexchange market.

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[40] Huber Report, Table L.15.

[41] *E.g.*, AT&T Memorandum in Support of Defendants' Motion for Involuntary Dismissal Under Rule 41(b) at 25-31 (July 10, 1981); Testimony of Robert D. Willig, AT&T, before the Pennsylvania Public Utility Commission, Generic Access Charge Investigation, Docket No. P-830452, February 24, 1984.

In regulatory contexts, it is in AT&T's interest to be more candid about the potential for bypass. Such frank talk convinces regulators that they must reduce the access charges that telephone companies bill to AT&T.[42]

AT&T has solved this dilemma by arguing one set of claims about bypass to the Court and a completely inconsistent set of arguments to the state and federal commissions. For example, AT&T assured the Public Service Commission in West Virginia that "bypass is readily available today" and that "bypass alternatives exist that are already cheaper than special access charges for very large customers."[43] In Texas, AT&T said:

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[42] AT&T implies that competition has caused its toll rates to decline 30% since divestiture. It fails to point out to the Court that most of this rate decrease was directly attributable to reductions in access charges billed to AT&T by the telephone companies. The costs involved, at commission direction, were billed instead to ratepayers in the form of flat-rate recurring charges. This change in rate structure was necessary to prevent bypass and AT&T repeatedly made that point to the FCC. See, e.g., Comments of AT&T, In the Matter of MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, FCC Common Carrier Docket Nos. 78-72 and 80-286 (August 26, 1986) at 4-5, 16-19.

> The overwhelming weight of the evidence confirms that facility bypass technology *today* is in an advanced stage of development, is relatively inexpensive when compared to the cost-reduction opportunities and is readily available to medium and high volume toll users.[44]

In a number of states, AT&T has also presented detailed engineering testimony explaining that bypass technologies were often cheaper than local exchange carrier services.[45]

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[43] Testimony of Mary E. Murphy, AT&T, before the Public Service Commission of West Virginia, General Rate Case, Docket No. 84-747-T-42T (June 3, 1985) at 7, 8.

MCI also claims in its pleadings to this Court that bypass is not practical even for high volume customers. MCI Comments at 18. This representation, however, like AT&T's claim, is inconsistent with MCI's representations to the regulators. In Texas, for example, MCI said that "the growing competition in the provision of facilities between interexchange carriers and their customers will no longer permit the subsidy from access service to local exchange service." MCI Brief, Rate Design, Application of Southwestern Bell Telephone for Authority to Increase Rates, Public Utility Commission of Texas, Docket No. 6200 (December 9, 1985) at 23.

[44] AT&T Brief, Rate Design, Application of Southwestern Bell Telephone Company for Authority to Increase Rates, Public Utility Commission of Texas, Docket No. 6200 (December 9, 1985) at 14 (emphasis in original).

[45] *E.g.*, Testimony and Exhibit B of John D. Schell, AT&T, before the Public Service Commission of West Virginia, General Rate Case, Docket No. 84-747-T-42T, June 3, 1985; AT&T Brief, Access Charge Phase, Generic Access Charge Investigation, Pennsylvania Case No. 83-0452, November 19, 1984 at pp. 42-43; Testimony of Robert D. Willig, New Jersey BPU Docket 8312-1126, January 20, 1984; AT&T Reply Comments, Virginia SCC Case PUC 850035, Investigation of Competition for IntraLATA, Interexchange Telephone Service, November 18, 1985.

AT&T is also willing to take advantage of bypass vulnerability when it comes to dealing with its customers. AT&T is actively marketing a short-haul microwave radio designed to bypass BOC services, "a compact, economical transmission system . . . that sends and receives information across the street or across town."[46] AT&T tells its customers that this system is so economical that it "can pay for itself in less than a year in most cases."[47]

AT&T has also restructured its service offerings--particularly those services which are used by private network customers--to give its high volume customers an incentive to bypass the BOCs.[48] Furthermore, AT&T has announced to its high volume customers that it would assist them to build their own facilities to interconnect with AT&T's private lines.[49]

In short, while AT&T is telling this Court no one could conceivably compete with the BOCs, AT&T and many others are doing just that. AT&T's repeated demonstrations to the regulators that bypass is a real competitive threat cannot be harmonized with its contrary claims to this Court that bypass is virtually impossible.

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[46] AT&T Network Distribution System DR 23 (undated AT&T promotional material).

[47] *Id.* at 4.

[48] These restructured tariff offerings include AT&T's private line tariffs as well as its Software Defined Network ("SDN") and Megacom and Megacom-800 offerings. Huber Report at 3.41, Table IX.18.

[49] Huber Report at 3.41 n.141.

B. The Lifting of Restrictions Will Not Deprive AT&T of Any Benefit That Induced It To Concur in the Decree.

AT&T took no responsibility for the line of business restrictions when the proposed Decree was originally made public. It told this Court, the FCC, Congress, the press and its shareholders that the line of business restrictions were not its idea.[50] Not having bargained for the restrictions, AT&T is in no position to contend that it has been denied any benefit to which it is entitled should the restrictions be lifted.

AT&T's public interest arguments against lifting the restrictions are both misplaced and transparent: misplaced because the applicable standard is not some vague and generalized "public interest" but the procompetitive standard of section VIII(C); transparent because the facts do not bear out its public interest claim that the decree minimizes litigation. The maintenance of the interexchange and manufacturing restrictions -- the only restrictions AT&T supports -- would not minimize litigation and uncertainty in the industry; on the contrary, these restrictions are a source of these very evils.

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[50] *See* 552 F. Supp. at 186 n.227; Transcript, June 29, 1982 at 25211; Brief of the FCC as Amicus On Question No. 1 (June 14, 1982) at 8-9, quoting from the FCC's March 24, 1982 hearing on the proposed decree.

The scope of the decree's interexchange restriction has been before this Court on a number of occasions. For example, the Court considered the meaning of this restriction in connection with Ameritech's motion concerning shared tenant services,[51] AT&T's complaint about PNB's service to the State of Oregon[52] and the Department's motion to compel Southwestern Bell to discontinue a business relationship with an interLATA reseller.[53] It is now before the Court on AT&T's motion concerning BOC operator services[54] and MCI's motion concerning database access for 800 service.[55]

The manufacturing restriction has also been the source of controversy. As early as April 1985, AT&T complained to the Department that three different regional companies were engaged in manufacturing in violation of the decree.[56] Another manufacturer, American Telecorp[57] and the North American Telecommunications Association[58] have complained to the Department about other supposed BOC manufacturing activities. In none of these cases did the Department find any violation of the decree. In addition, AT&T used the uncertainty about the scope of the manufacturing restriction to delay turning over to Bellcore, for more than two years, certain software to which Bellcore was entitled at divestiture.[59]

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[51] United States v. Western Elec. Co., 627 F. Supp. 1090, 1099-103 (D.D.C.), appeal dismissed, 797 F.2d 1082 (D.C. Cir. 1986).

[52] Memorandum Order (June 28, 1985).

[53] Memorandum order (April 11, 1985).

[54] AT&T's Motion for Declaratory Ruling on Operator Call Handling (Aug. 20, 1986).

[55] Motion To Cease Deployment of Interexchange and Information Service Capabilities in BOC 800 Service Database (March 12, 1987).

[56] Letter from Jim G. Kilpatric, AT&T, to Kevin R. Sullivan, Department of Justice, dated April 29, 1985.

AT&T is even trying to inject one of these disputes over the scope of the manufacturing restriction into this proceeding. In its comments, AT&T claims that the decree prohibits a BOC from participating in designing the telecommunications equipment it needs for its own use.[60] AT&T had previously made this claim to the Department in connection with its consideration of an Ameritech waiver request.[61] In response to this claim, Bell Atlantic[62] and others demonstrated that the language of the Decree did not support AT&T's argument and that the Court expected the BOCs to be involved in developing design specifications for the equipment they purchased.[63]

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[57] Letter from Thomas J. Casey, attorney for American Telecorp, to Michael F. Altschul, Department of Justice, dated August 19, 1985.

[58] Letter from Albert H. Kramer, attorney for NATA, to Kevin R. Sullivan, Department of Justice, dated January 14, 1986.

[59] *See* letter from Kevin R. Sullivan, Department of Justice, to Jim G. Kilpatric, AT&T, dated October 25, 1985.

[60] AT&T's Comments at 82.

[61] Letter from Francine J. Berry, AT&T, to Nancy C. Garrison, Department of Justice, dated October 30, 1986.

In any event, the precise definitions of what a BOC may and may not do consistent with the decree's interexchange and manufacturing restrictions are complex matters. This has contributed to the proliferation of litigation concerning the meaning of the decree's terms, resulting in the parties' spending a reported $75 million on decree-related disputes since divestiture.[64]

III. THE SPECIFIC RELIEF REQUESTED BY BELL ATLANTIC MEETS THE VIII(C) STANDARD.

Bell Atlantic obviously wants the same freedom to operate under the decree as may be granted to any of the other subject companies. Some BOCs, particularly with respect to the interLATA restriction, may request broader relief than others. Consequently, Bell Atlantic's motion and proposed order requests equivalent relief should such relief be granted to any other regional company or BOC that goes beyond the interLATA authority specifically requested herein.

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[62] Letter from John M. Goodman, Bell Atlantic, to Nancy C. Garrison, Department of Justice, dated December 11, 1986.

[63] "[T]he operating companies will, of necessity, have to negotiate with independent equipment manufacturers over a variety of contractual terms (e.g., specification and design terms, volume contracts, trademark licenses) in order to obtain a distinctive line of products for resale." United States v. Western Elec. Co., 569 F. Supp. 1057, 1089 n.133 (D.D.C.), aff'd mem., 464 U.S. 1013 (1983).

[64] Wall Street Journal, dated April 8, 1987, at 6.

A. The Limited InterLATA Relief Requested by Bell Atlantic Is Conditioned on Reciprocal Competitive Entry by Others Within Bell Atlantic's Region and Avoids Any Bottleneck or Network Discrimination Concerns.

Bell Atlantic is not asking to provide general toll services within its region. It is asking for those rights outside its region where there can be no conceivable claim that it controls the local exchange network.

1. Private Network Services and Packet Services.

Within its region, Bell Atlantic requests authority to provide a small group of large customers with a limited set of services for which these customers have many competitive alternatives. These services are private network services and consist of private line circuits associated with dedicated switches.[65] The Court has already made clear that the BOCs are entitled to offer the switching associated with private networks, provided the customer directs the routing of traffic to any circuits that cross LATA boundaries.[66] Additional waiver relief is necessary to permit Bell Atlantic to provide the interLATA circuits.

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[65] Huber Report at 3.45:

> A private network consists of transmission facilities, nodal switches, and other customer premises equipment configured for the exclusive use of a single, geographically dispersed organization.

Permitting the BOCs to provide these services would promote competition. This market is highly concentrated, and AT&T is by far the largest provider of these services.[67] Moreover, there is evidence that AT&T is attempting to manipulate this market, forcing customers to migrate to new AT&T network services with private line characteristics.[68] The BOCs are the most logical competitive counterweight to AT&T in this market, just as they were in the CPE market in 1982.[69]

Nor do the BOCs have bottleneck control over these networks, even though the BOCs do supply some services -- such as local private lines -- for these networks. There are ready bypass alternatives for local private lines. For example, the fiber optic bypass system now operational in Washington, D.C. actively promotes its ability to replace BOC private lines connecting customer locations or connecting a customer's PBX to an interexchange carrier's point of presence.[70] A growing number of microwave vendors are pursuing the same market.[71] To the extent these competitive private networks choose to use local BOC private lines, they will be ordering "plain vanilla" facilities, any degradation of which can be readily detectable.

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[66] This was the Court's holding when it rejected AT&T's complaint that PNB's service to the State of Oregon violated the decree. Memorandum Order at 3-4 (June 28, 1985). In spite of this fact, AT&T is challenging a similar switching service provided by another US West company. Letter from Francine J. Berry, AT&T, to Nancy C. Garrison, Department of Justice, dated March 5, 1987. The Bell companies have responded, demonstrating that the service in question is permitted by the decree and this Court's prior orders. Letter from Saul Fisher, NYNEX, to Nancy C. Garrison, Department of Justice, dated March 25, 1987.

[67] *See* "AT&T Rides Out Private Line - Private Network Storm," *Communications Week* (April 13, 1987).

[68] *Id*.

[69] 552 F. Supp at 192.

Bell Atlantic also seeks authorization to provide interLATA private lines to the packet switch networks of itself and others. These networks are simply a specialized type of private network used by one type of high volume customer -- database providers -- to provide their own customers with access to their service.

As with other private networks, AT&T now provides the overwhelming share of interLATA links for these packet networks.[72] Allowing the BOCs into this business would also further competition.

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[70] Bell Atlantic Comments at 12; Huber Report at 2.13 - 2.15.

[71] Bell Atlantic Comments at 12-13; Huber Report at 2.16.

[72] Huber Report at 5.11.

2. InterLATA Consulting.

Some large customers, including multilocation banks, state governments and large industrial enterprises, want their telecommunications vendors to be able to recommend complete telecommunications systems. To meet this customer requirement, Bell Atlantic requests authority to provide consulting services on all aspects of interLATA service, but only to those large customers needing private network services. These customers represent no more than one percent of the total customer body.[73]

The right requested does not include resale of service; it does include the right to serve as an ordering agent, assisting eligible customers in assembling the package of interLATA and intraLATA services which best meet their needs. Except for private line services and such other specialized business services that Bell Atlantic may be authorized to provide within its region, the consulting service that Bell Atlantic would provide is similar to the vendor coordination service that the Court has previously encouraged the BOCs to make available to their customers.[74]

The Department has concluded that the GTE telephone companies, even without a waiver, have the right to recommend interLATA services to all of their customers. The GTE situation should logically present a harder issue: the GTE telephone companies have an affiliated, general toll carrier operating out of their exchanges that they might be tempted to favor. Under the limited relief requested by Bell Atlantic, there would be no comparable incentive to discriminate.

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[73] Huber Report at 3.44.

[74] United States v. Western Elec. Co., 627 F. Supp. 1090, 1102 n.51; 592 F. Supp. at 863.

3. 800/WATS Services.

Bell Atlantic also requests authority to provide interLATA WATS and 800 services. For these services, interexchange carriers already have the equivalent of 100% equal access. Moreover, Bell Atlantic would have no dialing advantage for these services.

For 800 service, Bell Atlantic already provides ubiquitous NXX access service, and the Court has found that this arrangement meets the BOCs' equal access obligation.[75] For WATS, equal access is also ubiquitously available.[76]

Bell Atlantic would not have any dialing advantage over its interexchange competitors because all 800 calls and WATS calls are completed by dialing the same way. There is no

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[75] United States v. American Tel. & Tel. Co., 604 F. Supp. 316, 322-24 (D.D.C. 1985).

[76] See Bell Atlantic Tariff F.C.C. No. 1, Transmittal No. 135 (January 20, 1987) which provides WATS access for OCCs even in areas where equal access is not available for general toll services.

"10XXX" dialing for either service. In addition, Bell Atlantic would use the same 800 access arrangements -- initially NXX and later database access -- to complete its 800 calls that it can make available to the interexchange carriers.[77]

4. Inter LATA Mobile Services.

Bell Atlantic should also be permitted to provide interLATA mobile services, including cellular and conventional mobile services.[78] Such authorization poses no risk of competitive harm.

LATA boundaries have a very different significance for mobile services than for ordinary long distance services. For long distance, the LATA line is a boundary designed to prevent the BOCs from providing interexchange service in competition with the interexchange carriers.

There is no comparable decree purpose to prevent the BOCs from competing with other mobile service providers, and a vigorous competition presently exists for these services.[79] The Department reports that this competition has not created any significant problems.[80] Allowing the BOCs to provide interLATA mobile service would do nothing to alter the state of competition in mobile markets. It will, however, make the BOCs mobile services more useful to their customers[81]

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[77] MCI and Sprint complain that they cannot freely compete to provide WATS and 800 services because of state regulatory restrictions. MCI Comments at 20-24; Sprint Comments at 15-16. Bell Atlantic's interLATA proposal, however, addresses these concerns. Under that proposal, Bell Atlantic would be permitted to provide a customer with interLATA WATS and 800 service only if interexchange carriers could provide intraLATA WATS and 800 service to that same customer. Bell Atlantic Comments at 16.

[78] Conventional mobile services include paging, conventional mobile telephone service, marine radio, and air-ground mobile services. Huber Report at 4.1-4.2.

The BOCs should also be allowed to resell interexchange service in order to complete calls made by their mobile service customers. For example, if a Bell Atlantic cellular customer in Washington makes a call to San Francisco, Bell Atlantic should be permitted to complete that call using a resold service provided by an interexchange carrier.

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[79] Huber Report at 4.19

[80] Department Report at 77-78.

[81] Many of the oppositions to specific expansions of mobile service interLATA boundaries have come from competitors who want to use the decree to differentiate their mobile service so that it will be broader in scope and more useful than a BOC's service. The Court has never countenanced such an imposition on the public.

Another class of opposition has been initiated by mobile services providers who have had specific interconnection disputes with particular regions and who seek, thereby, to use the LATA waiver process as a negotiating lever or a means of retaliation.

To its knowledge, Bell Atlantic has no such interconnection disputes pending. In any event, this is not a legitimate use of the waiver process, particularly because it is clear that the decree was not drafted to govern the terms of interconnection between BOCs and non-interexchange carriers. Response of the United States to Public Comments or Proposed Modification of Final Judgment at 99-100 (May 20, 1982).

AT&T objects to this relief, claiming that the BOCs would have an incentive to manipulate the price and quality of access facilities,[82] but that claim lacks merit. The interLATA traffic involved is a mere trickle.[83] It is simply implausible that Bell Atlantic would attempt to degrade or manipulate access services provided to AT&T or any other carrier for that amount of traffic.

5. The Reciprocity Principle.

In every case, Bell Atlantic would be willing to condition the interexchange relief it has requested on the reciprocal elimination of state barriers to entry in any LATA or portion thereof in which Bell Atlantic will exercise its waiver authority.

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[82] AT&T Comments at 78. AT&T also claims that Bell Atlantic failed to release lists of Bell Atlantic's cellular customers and that this interfered with AT&T's ability to sell interexchange service to these customers. AT&T Comments at 77. AT&T's assertion is misleading and erroneous. In the highly competitive cellular business, customer lists are "hit lists" for competitors. While Bell Atlantic did decline to release this highly proprietary information directly to AT&T, it did release it to a third-party telemarketing firm selected by AT&T. This protected Bell Atlantic's sensitive competitive information without interfering with AT&T's marketing efforts.

[83] For example, only 5.9 percent of all calls originated by Bell Atlantic cellular customers terminate outside of the local cellular serving area, and these calls are less than 0.024 percent of the total number of interexchange calls originating in Bell Atlantic's territory.

This could mean that, in some jurisdictions, Bell Atlantic will not be able to provide the requested services for an indeterminate period of time. In other jurisdictions, state regulators have already issued orders announcing that state barriers will be promptly eliminated when the reciprocal federal barriers to competition are removed.84/

B. Lifting The Manufacturing Restriction Will Improve Rather Than Impede Competition.

The Court has recognized that a close affiliation between a telephone company and a manufacturer produces better service and better equipment. These were the reasons that led the Court to approve a decree that permitted AT&T to retain Western Electric and Bell Labs.85/ The same reasons support the complete removal of the manufacturing restriction now imposed on the BOCs, and a number of manufacturers endorse that relief.86/

AT&T and some intervenors, oppose that relief, claiming that BOCs could foreclose the market or otherwise harm

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84/ *See*, Interim Order, Case No. PUC850035 (Va. S.C.C. June 30, 1986) (stating intraLATA competition will be allowed when federal barriers to interLATA competition are removed).

85/ 552 F. Supp. at 167.

86/ *See* n.8, *supra*. Moreover, the Department has recognized that manufacturing relief may well accelerate the pace of technological innovation, thereby bringing new services more rapidly to consumers. Department Report at 182.

competition, particularly if they were allowed to manufacture CPE,[87] CPE-like processors,[88] or central office equipment.[89] Under current industry conditions, there is no substantial possibility that those dangers would occur. On the other hand, there are good reasons why BOC participation in these activities should produce competitive goods at competitive prices.

1. Customer Premises Equipment.

CPE is not a class of products for which competition can be foreclosed by in-house purchases.[90] The amount of CPE purchased by the BOCs for their own use is a very small share of the total market.[91] CPE must be sold in a very competitive end-user market and its price and features must satisfy marketplace standards.

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[87] *E.g.*, North American Telecommunications Association Comments at 10-24.

[88] USTSA Comments at 35.

[89] *E.g.*, AT&T Comments at 97-101.

[90] Customer premises equipment includes PBXs and other terminal gear, and other equipment such as modems, multiplexers, and network channel terminating equipment. Although this equipment is often located on a customer's premises, Bell Atlantic seeks authorization to manufacture it regardless of its ultimate location -- whether on a customer's premises, the central office, or some other location.

[91] Huber Report at 16.6; chapter 17.

CPE is also not a class of products for which the BOCs could manipulate network standards in its hope of favoring their own equipment. First, as previously explained, the BOCs do not set such standards in the post-divestiture world.[92] Second, the FCC's interconnection standards and its recently adopted network information disclosure rules provide additional protection.[93]

Furthermore, any CPE manufactured to unique BOC network standards would be unmarketable outside of the BOC's region. Even within that region, large customers with private networks or other equipment which did not conform to unique standards would also be unable to use the BOC's CPE.

There is no plausible reason why Bell Atlantic or any other BOC would want to shut itself out of these kinds of markets. Certainly, GTE, a regional-sized exchange carrier which is allowed to manufacture, is not doing so. Instead, it is actively trying to market its CPE to as wide a market as possible, and there is no suggestion that GTE has even attempted to manipulate network standards. There is no reason to believe that a BOC would behave any differently.

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[92] See pp. 12-13, *supra*.

[93] Part 68 of the FCC's rules provide a detailed set of interconnection standards for CPE. 47 C.F.R. Sec. 68.1 et seq. (1986). Moreover, if a BOC decides to install any network equipment which will cause interconnection specifications to change, it must disclose that fact, along with preliminary interface specifications, to all unaffiliated vendors and manufacturers when the BOC makes the decision to deploy. *See* Furnishing of Customer Premises Equipment by Bell Operating Telephone Companies and the Independent Telephone Companies, CC Docket No. 86-79, Report and Order (January 12, 1987), ¶¶ 47-54. The final specifications must be disclosed six months to a year before the BOC actually deploys the network equipment. *Id*. at ¶ 54.

Finally, despite AT&T's claims,[94] the nation's trade interests would not be harmed if the BOCs were permitted to manufacture CPE. Foreign manufacturers now sell a substantial amount of most kinds of CPE in the United States -- from simple handsets to the most complex PBX,[95] and these foreign manufacturers are working vigorously to expand their sales here.[96] In this market, allowing the BOCs to manufacture CPE could very well help rather than harm the nation's trade interests.

2. Adjunct Processors.

Bell Atlantic should also be permitted to manufacture adjunct processors--computers with specialized software which are used to provide such services as voice mail, data networking capabilities, and call accounting.[97] These processors can be used to provide services through a BOC central office, or they can be directly connected to a customer's PBX.[98]

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[94] AT&T Comments at 99-101.

[95] NTIA Trade Report at 36-44.

[96] *Id.*

[97] Huber Report at 14.17, Table CO.11a.

The reasons for permitting Bell Atlantic to manufacture adjunct processors parallel the reasons for CPE manufacturing relief. First, BOCs have no incentive to manipulate interconnection specifications or network standards for this equipment. Most of this equipment is purchased not by telephone companies, but by PBX customers for connection to their PBXs.[99] Therefore, if Bell Atlantic manufactured an adjunct processor based on some unique network standard, it would foreclose itself from the largest portion of the adjunct processor market.

Second, because BOCs' purchases account for only a small share of the adjunct processor market, BOCs could not foreclose competition by manufacturing this equipment for themselves. Indeed, because adjunct processors are really just computers with specialized software,[100] and because the computer market is so large, there is no realistic risk of market foreclosure.

Nor would a BOC have an incentive to buy an adjunct processor from an affiliate at an inflated price. The services which a BOC would provide through a central-office based adjunct processor are competitive with services provided by similarly equipped PBXs. If BOCs purchased adjuncts at inflated prices, they would simply undercut their ability to compete with PBX alternatives.

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[98] Id.

[99] Huber Report at 14.17.

[100] See Eastern Management Group, "Telephone Ancillary Equipment" (1986).

3. Central Office Switching Equipment.

BOC manufacture of central office switching machines similarly poses no risk of competitive harm. The most significant reason is the state of the central office switching market itself. Because of the economics of central office switch manufacture, including the enormous research and development costs required to develop a switch, "[a]ll manufacturers have concluded that to remain in today's market for [central office] switches they must operate at a scale considerably broader than the market represented by a single [regional company]. . . ."[101] Therefore, a regional company could not develop and sustain a central office manufacturing operation which satisfied only its own requirements.

As a result, a BOC could not manufacture central office equipment based on some unique regional network standards. If it did, the equipment would be unmarketable in the extra-regional markets which are critical to sustain the operation. Similarly, a BOC could not purchase central office equipment from itself at inflated prices. If it tried to do so, the difference between its sales price to other parties and its sales price to its own telephone companies would immediately expose the practice.

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[101] Huber Report at 14.14.

AT&T claims that the BOCs should not be permitted to manufacture central office equipment because, if so authorized, the BOCs would all enter into joint ventures with foreign manufacturers, effectively foreclosing the United States central office equipment market to AT&T.[102] Ameritech refers to this possibility as the "Seven Brides for Seven Brothers" argument -- an event so unlikely that, the last time it happened, Hollywood made a musical about it.

It is AT&T's dual role as a manufacturer and a common carrier competitor that is driving the BOCs to purchase central office equipment from other manufacturers. If a BOC buys a central office switch from AT&T, it is dependent on AT&T for any upgrades to that switch or additions to that switch.[103] BOCs are anxious to avoid this dependence on AT&T because AT&T is also a principal competitor of the BOCs for network services.

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[102] AT&T Comments at 97-101. This represents another AT&T change of position. AT&T previously told this Court that the relevant market is a world market which includes not only all central office equipment, but also all data processing equipment. *See* Defendants' Memorandum Responding To The Government's Initial Presentation of Market DATA and Setting Forth Defendants' Views on Markets and Submarkets at 28-41 (October 12, 1979); Defendants' Response to Plaintiff's Motion to Correct Departures in Defendants' Market Contentions at 5-6 (March 11, 1981).

For example, AT&T sells PBXs which compete head-to-head with BOC switching services, such as Centrex,[104] and AT&T is also reportedly preparing to offer its own network-based Centrex services.[105] BOCs fear that AT&T will provide upgrades to its own customers more quickly or at a lower cost than it will for the BOCs. In fact, AT&T has already done so.[106] The BOCs are actively seeking to purchase central office switches from manufacturers other than AT&T because AT&T presently has a "manufacturing bottleneck."

Continuing to bar the BOCs from manufacturing central office equipment will not alter the BOCs' basic incentive to avoid increasing reliance on a formidable competitor. Lifting the restriction, however, will create the possibility of maintaining a strong American presence in the central office switch market.

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[103] Even if all BOCs begin manufacturing central office switches, they would still have to rely on AT&T for additions and upgrades to the vast amount of AT&T switches in the BOCs network.

[104] Huber Report at 2.5 - 2.7.

[105] Huber Report at 2.4 n.9. AT&T and the BOCs are already competing, particularly for large business customers. AT&T provides these customers with complete communications systems that substitute for most of the sophisticated business services that can be provided by the BOCs.

[106] Based upon the information currently available to Bell Atlantic, AT&T is today providing features in its System 85 PBX that are not available in its current generation of central office switches. Examples are Automatic Recall, Automatic Call Distribution, and Alphanumeric Console Display features, which are now available in the System 85 but will not be available in the 5ESS central office switch until 1988 or 1989. Communications Week, February 16, 1987, at 1.

C. The Information Services Restriction Should Be Removed.

The information services prohibition should also be lifted. Although this restriction was intended to foster the development of information services,[107] post-divestiture experience shows that it has had precisely the opposite effect, retarding the development of information services, particularly for the mass market.

1. The Information Services Restriction Has Stifled Development of Information Services Markets.

Five years ago, when the Court approved the information services restriction, neither the Court nor the parties could fully appreciate the vital role of the BOCs in delivering information services. Information services were then in their infancy both here and abroad; nowhere had telephone companies taken a leading role in delivering such services.[108] Consequently, the Department of Justice believed that most information services could be efficiently provided by other vendors.[109]

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[107] 552 F. Supp. at 189.

[108] For example, many of the information services offered by foreign telephone companies had not even been introduced in 1982. Huber Report, Table IS.21.

Now, however, there is convincing proof that this is not the case. For example, comments filed by the Videotex Industry Association ("VIA"), a broad-based trade association formed to promote electronic services, explain that, because BOCs have not been permitted to provide information services, the infrastructure necessary for mass delivery of database services has not developed in this country.[110] Instead, information services in this country have been available only to the economically privileged.[111]

By contrast, the mass information services market in France is far more developed because the French telephone company has been permitted to participate in providing information services.[112] Nor is the French telephone network an isolated example. Other countries, such as Canada and Japan, have permitted their telephone companies to provide similar networks, and they too are experiencing dramatic growth.[113]

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[109] The Department asserted that the information services ban "would not foreclose the offering of services. . . ." Department of Justice Response, May 20, 1982, at p. 65. At the time, the FCC took a similar position, allowing the Bell System to provide information services only through fully separate subsidiaries. Second Computer Inquiry, 77 F.C.C.2d 384 (1980), modified, 84 F.C.C.2d 50 (1980), aff'd sub nom, CCIA v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983).

[110] VIA Comments at 8-11. ANPA claims that the French system has developed because the French telephone company has cross-subsidized the sale of terminals used in the system. ANPA Comments at 30. That claim is mistaken. The terminal is an expensive piece of equipment; to encourage use of its information network, the French telephone company has charged a modest fee for the terminal itself, and recovered the rest of the terminal's cost through usage sensitive charges collected from users of the system. VIA Comments at 14-15.

[111] VIA Comments at 7.

2. There Is No Realistic Risk of Competitive Harm If the Information Services Restriction Is Lifted.

Lifting the information services restriction will not lead to any realistic risk of discrimination or other competitive harm. Indeed, particularly for database services, the BOCs have an incentive to encourage independent vendors.

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[112] *Id.* at 13-14.

[113] Huber Report, Table IS.21. The American Newspaper Publisher's Association claims that, despite the information service restriction, America remains the world leader in information services. America is advanced in serving the niche market for high volume, sophisticated customers who can afford to pay for high priced information services. *E.g.*, Huber Report at pp. 7.1-7.3 and Tables CDB.2 and CDB.3. It is in the mass market where America is falling behind. Huber Report at 6.47.

In Tokyo, for example, every telephone subscriber has access to an inexpensive, telephone-based voice-mail system. Although the service was introduced only last December, it now processes 50,000 calls. Business Week, February 16, 1987, at 104c. In the United States, there are virtually no such offerings, except among the independent telephone companies who are not bound by the information services restriction. Huber Report at 6.43. It is for that reason that the United States' leading provider of mass market information services may well be the Chillicothe Telephone Company. *Id.*

In France, 2.3 million customers have access to information services, including sophisticated database services, over the local network. VIA Comments at 16. In the United States, a country with a population at least five times as large as France, there are only 500,000 customers who have access to such services.

Unlike the long distance market, which could practically be served by one carrier--and was served by one carrier prior to divestiture--database services are specialized offerings provided by a wide variety of vendors with particular expertise.114/ For example, legal information services are provided by companies with legal expertise, while financial information services are provided by different companies with financial expertise.115/ No single company has the underlying expertise to be a comprehensive provider of information services.116/

In this environment, it is extremely unlikely that a BOC would try to keep independent information service providers from using the local network. The BOCs' rational economic incentive is to encourage local network usage. By designing their networks to accommodate the greatest number of

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114/ Huber Report at 7.1.

115/ Huber Report at 7.5.

116/ Huber Report at 7.3.

information service providers, the BOCs stimulate usage and produce greater revenues and earnings. This is what the French telephone company has done, and this is why a number of database providers in this country want the BOCs in the information services business.[117/]

Furthermore, a BOC's opportunity to discriminate against an information service competitor is quite limited, despite the claims of some intervenors that they depend on BOC services.[118/] Those BOC inputs are commodity-type services -- dial-up access and private line -- which do not give the BOCs any realistic opportunity to discriminate in terms of quality or price.[119/]

Any residual risk of discrimination is eliminated by FCC's new Computer III rules, and the Open Network Architecture ("ONA") requirements of those rules. Since 1985, the Justice Department has publicly taken the position that ONA could make the information services restriction unnecessary.[120/] By requiring equal access to network facilities,[121/] disclosure of

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[117/] E.g., VIA Comments at 8-13.

[118/] ANPA Comments at 35-39; Dun & Bradstreet Comments at 12-14; Compuserve Comments at 24-30.

[119/] Huber Report at 10.17 - 10.18; 10.23 (messaging); 9.6 - 9.7 (electronic yellow pages).

[120/] Comments of the United States Department of Justice, Third Computer Inquiry (November 13, 1985) at 27-28.

[121/] Computer III at ¶¶ 160, 163, 218.

planned network design changes and of customer proprietary information, documentation of non-discrimination, equality in maintenance, and the unbundling of services, Computer III creates an environment in which discrimination is highly unlikely.[122]

3. The Decree's Prohibition of BOC Electronic Publishing Violates the First Amendment.

ANPA and some other intervenors claim that the information services restriction, and particularly the prohibition of electronic publishing by the BOCs, is mandated by the first amendment, claiming that: (1) the first amendment countenances the promotion of speech by some through the silencing of the speech of others;[123] and (2) the BOCs' first amendment rights are satisfied because the BOC can use media other than electronic media. It also asserts that this Court has previously accepted these principles. All of these claims, however, are mistaken.

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[122] Some intervenors claim that Bell Atlantic's recent filing with the FCC concerning a proposed message storage service demonstrates that BOCs will discriminate against their information service competitors. These intervenors assert that Bell Atlantic proposes to charge itself a lower interconnection rate than it charges to its competitors even though the interconnection facilities involved are the same. TRINTEX Comments at 13-14; ADAPSO Comments at 34-35. The facilities used, however, are not the same. Bell Atlantic's filing passes on to its customers the savings made possible by integrating the necessary equipment into the telephone network.

[123] E.g., Comments of ANPA at 2, 5-6 (contending that the Court has adopted the "Diversity Principle," a principle that ANPA defines as requiring the exclusion of the BOCs from electronic publishing).

As this Court previously noted, the first amendment favors the achievement of "the widest possible dissemination of information from diverse and antagonistic sources."[124] It is well settled that "to restrict the speech of some . . . in order to enhance the relative voice of others is wholly foreign to the First Amendment. . . ."[125]

Associated Press v. United States,[126] on which ANPA relies,[127] actually supports Bell Atlantic's position. In that case, the Supreme Court found that the bylaws of the Associated Press, which prohibited members from furnishing news to non-members and permitted members to block their competitors from becoming members, violated the Sherman Act, and that first amendment principles did not immunize the Associated Press from antitrust liability.[128] The Court found that AP's rules were designed "to keep others from publishing,"[129] and that the first amendment could not countenance such a result. For the same reason, the decree's blanket prohibition on BOC electronic publishing violates the first amendment.

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[124] 552 F. Supp. at 183.

[125] Buckley v. Valeo, 424 U.S. 1, 48-49 (1976). Accord, Pacific Gas and Elec. Co. v. Public Utilities Comm'n of California, 106 S. Ct. 903, 911 (1986); Quincy Cable TV, Inc. v. FCC, 768 F.2d 1434, 1452 (D.C. Cir. 1985), cert. denied, 106 S. Ct. 2889 (1986).

[126] 326 U.S. 1 (1945).

[127] ANPA Comments at 5.

[128] 326 U.S. at 4, 7, 19-20.

[129] Id at 20.

Moreover, there is no merit to the suggestion that if the BOCs wish to disseminate information, their interests are adequately served by being able to publish in other media or forums.[130] It is hornbook first amendment law that "one is not to have the exercise of his liberty of expression in appropriate places abridged on the plea that it may be exercised in some other place."[131] Also, no alternative media provides the same contemporaneous transmission of textual information and ability for user-interaction as does electronic publishing.[132] In sum, the suggestion that the restraint might be immune from first amendment scrutiny because the BOCs can "speak elsewhere" is little short of frivolous.

Finally, despite the newspaper publishers' claims, it is simply implausible to assume that this Court would have embraced the novel view of the first amendment they attribute to it. Although the Supreme Court has recently reaffirmed the basic principle that diversity cannot justify the burdening -- much less suppression -- of speech,[133] the point was well understood in 1982.[134] Thus, the Court's 1982 opinion simply cannot be read to state what the proponents of the electronic publishing ban now suggest: that a restraint on speech is automatically justified if promulgated in the name of diversity, even where the restraint directly stifles the speech of others.

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[130] ANPA Comments at 13, n.40.

[131] *Schneider v. State*, 308 U.S. 147, 163 (1939). *Accord* *Southeastern Promotions, Ltd. v. Conrad*, 420 U.S. 546, 556 (1975); *Schultz v. Frisby*, 807 F.2d 1339, 1347 (7th Cir. 1986); *NAACP v. City of Richmond*, 743 F.2d 1346, 1355, n.8 (9th Cir. 1984); *Grace v. Burger*, 665 F.2d 1193, 1204 (D.C. Cir. 1981), *aff'd in relevant part* *sub nom*. *United States v. Grace*, 461 U.S. 171 (1983).

[132] *Cf*. *Linmark Associates, Inc. v. Willingboro*, 431 U.S. 85 (1977) (noting that where, in practice, consumers expect certain information to be conveyed through a particular media, alternatives are inadequate).

D. The "Catchall" Restriction, Section II(D)(3), Should Be Removed Entirely; Existing Waivers of That Section Should Be Vacated; If Any Conditions Are To Apply to Section II(D)(3) Waivers, They Should Be Generic and Apply to All Nontelecommunications Activities.

Relatively few commentors focused on the section II(D)(3) restriction.[135] Of those who did, a number of them supported the removal of this restriction in its entirety.[136] The general absence of comment on this matter confirms that BOC entry into nontelecommunications businesses does not present significant antitrust issues.

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[133] *Pacific Gas & Electric*, 106 S. Ct. at 910-11.

[134] *Buckley v. Valeo*, 424 U.S. at 47-49.

[135] More than eighty intervenors did not address the Department's recommendation to remove this restriction.

[136] *E.g.*, California Public Utility Commission Comments at 11; GTE at 5; Virginia State Corporation Commission at 5; Motion Picture Association Comments, Appendix *passim*; USTA at i.

The Court's initial reaction to the section II(D)(3) restriction was one of skepticism[137] because the Court realized that the restriction was "directly anticompetitive."[138] Further, the Court never accepted the "quarantine" theory on which the restriction was based.[139] On the other hand, the Court assumed that the regional companies would not be interested "in entering such unrelated competitive businesses" and that any such requests would be rare.[140]

In fact, many waivers of section II(D)(3) have been requested, and well over 100 have been granted by the Court. Long delays, however, have attended the process, sometimes exceeding a year.[141] The Department has generally promptly processed "me-too" waivers which have been requested to mirror authority already granted to other regional companies; however, delays as long as eight months have been encountered for "me-too" waivers as well.[142]

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[137] United States v. American Tel. & Tel. Co. 552 F. Supp. 131, 187, 195 n.267 (D.D.C. 1982).

[138] Id. at 186-7.

[139] This was the notion that regulated entities were an aberration in an otherwise free market economy and had to be barred from intruding on or otherwise upsetting the workings of the free market. However, the same theory was not applied by its proponents to either AT&T, GTE or any other telephone company.

[140] 592 F. Supp. at 853 n.11, 858.

[141] For example, Southwestern Bell's advertising waiver request, which was recently granted by the Court, had been pending for nineteen months, fourteen of them at the Department.

AT&T suggests a way to eliminate these delays and yet also to assure that any line of business entered by a regional company does not constitute an activity which remains prohibited to the regionals under the decree.[143] Pursuant to the proposed procedure, the regional would give the Department two weeks notice of the business it intends to enter; in the absence of objection, the regional company would be deemed authorized to enter the business; the only objection that would preclude such entry would be a timely claim that the business sought to be entered was still barred to the BOCs under the decree.[144]

The question remains whether, if the Court removes the section II(D)(3) restriction, it should be subject to any substantive conditions. As pointed out in Bell Atlantic's

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[142] *E.g.*, Ameritech's financial services waiver.

[143] AT&T's Comments at 115.

[144] AT&T suggests that, if a timely objection is interposed, the FCC should screen the contested waivers and then, presumably, report back to the Court. Bell Atlantic disagrees with this aspect of AT&T's proposal for the reasons set forth at pp. 36-38 of Bell Atlantic's March 13 Comments.

Bell Atlantic proposes instead that the Department have thirty days to review the objection. If the Department does not notify the regional company within that period that, in the Department's view, the objection is well-founded, the regional would be free to begin operations. On the other hand, if the Department does endorse the objection, the regional company should have a right to obtain a ruling from the Court.

March 13 Comments, many of the existing waiver conditions are arbitrary and inconsistent.[145] Some, such as the 10% net revenue cap, are entirely unrelated to antitrust concerns and produce results that the Court could not have intended.[146]

Other conditions that occur in some of the waivers, such as those which entirely bar some transactions between a regional company's waivered business and its telephone companies, seem primarily motivated by regulatory concerns rather than a need to protect competition. The regulators themselves, however, have mechanisms at their disposal to review and monitor such transactions, short of outright prohibition, to assure that these transactions do not disadvantage ratepayers. The FCC's Joint Cost Order is one example of such a mechanism; another is the affirmative burden of proving the reasonableness of all costs incurred in affiliated transactions that telephone companies must discharge in their rate cases.[147] Still another mechanism are the statutes that many states have enacted that require prior commission approval for telephone company transactions with affiliates.[148]

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[145] Bell Atlantic Comments at 30-36. The existing procedures to obtain waivers give the regionals no recourse to the Department's demands for the acceptance of conditions. There are no time limits to the Department's waiver application review and it can simply let waiver requests remain pending if its conditions are not accepted.

There are currently 38 waiver requests pending before the Department. Nine have been pending well over a year; another thirteen for more than six months. (No waiver request presently before this Court has been pending for more than six months.)

Generally, the Department seeks to satisfy objections to waivers with an applicable condition. The regionals, for their part, are involved in commercial transactions that will be destroyed or impaired by delay. Consequently, the regionals have acquiesced in many unnecessary and arbitrary conditions.

[146] Bell Atlantic Comments at 30-33.

Whatever the justification might have been for imposing such conditions shortly after divestiture when the impact on local telephone service of divestiture-related events was uncertain, such justification no longer exists.

The BOCs are still investing billions of dollars a year in their construction programs to maintain and improve telephone service.[149] Local rate increases that occurred prior to and at the time of divestiture have tapered off and now few, if any, general rate increases are pending.[150] Bell Atlantic has had no general rate increase pending since January 1986; it has neither sought nor received increases in local rates since that time.

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[147] In rate proceedings, opponents of rate increases generally have the burden of challenging particular costs; only then do the regulated entities have the burden of proving the costs in controversy are reasonable. See, e.g., West Ohio Gas Co. v. Public Utilities Comm'n, 294 U.S. 63, 72 (1935); Southwestern Bell Tel. Co. v. Public Service Comm'n, 262 U.S. 276, 288-9 (1923); City of Norfolk v. The Chesapeake & Potomac Tel. Co., 192 Va. 292, 64 S.E.2d 772, 783-4 (1951). Where costs arise out of affiliated transactions, however, the regulated entity has an affirmative obligation to prove the reasonableness of the resulting costs even in the absence of a specific challenge to the costs or to the transaction. See, e.g., Smith v. Ill. Bell Tel. Co., 282 U.S. 133, 157 (1930); Solar Electric Co. v. Pa. Pub. Util. Comm'n, 137 Pa. Super 325, 9 A.2d 447, 473 (Pa. Super. Ct. 1939); New England Tel. & Tel. Co., 62 P.U.R.4th 503, 531-2 (Vt. Pub. Serv. Bd. 1984); Chesapeake & Potomac Tel. Co., 43 P.U.R.4th 169, 207, 210-11 (D.C. P.S.C. 1981).

[148] Code of Virginia § 56-77; West Virginia Code § 24-2-12.

[149] Bell Atlantic Comments, Appendix A at 1.

At the same time, Bell Atlantic has increased the number of households with telephone service in its region to 95%, an all-time high. All equal access commitments under the decree have also been met by Bell Atlantic.[151]

Under these circumstances, no substantive conditions should be placed on the Court's removal of section II(D)(3). Conditions aimed at ratepayer protection are neither required nor legally appropriate. Restrictions based on antitrust considerations have not proven to be necessary for nontelecommunications activities.

The Court did not require the provision of CPE to be conducted subject to conditions. The FCC, however, imposed such conditions on CPE provisioning as it thought necessary for ratepayer protection.[152] To the extent similar ratepayer protection is deemed necessary by reason of other activities, the regulators have comprehensive jurisdiction over the telephone companies, over their costs allowable for ratemaking purposes, and over the quality of their service.

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[150] Summary of State Telephone Rate Cases, Industry Analysis Division, FCC Common Carrier Bureau (March 31, 1987) at Table 2.

[151] As of the present time, Bell Atlantic provides equal access on 84% of its access lines, far exceeding its Decree obligation. It will continue to deploy equal access, even in the absence of bona fide requests, until it eventually provides equal access in all of its central offices.

If the Court nevertheless concludes that some substantive conditions should apply, only two generic conditions are necessary: (1) confirming decree surveillance over the waivered activity; and (2) reaffirming that authority to conduct the nontelecommunications business does not confer with it the authority to enter lines of business that remain foreclosed under the decree.[153]

CONCLUSION

Competition is the American way. When given a choice, however, entrenched suppliers will always look for some other way. This explains the origin of many of the pleadings now before the Court.

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[152] The FCC regime protects the interests of competitors as well by requiring: (1) early public disclosure of network interconnection specifications; and (2) the filing of reports comparing the installation and maintenance services provided to customers who order CPE from BOC affiliates with the services provided to customers who order CPE from unaffiliated vendors. See Furnishing of Customer Premises Equipment by Bell Operating Telephone Companies and the Independent Telephone Companies, CC Docket No. 86-79, Report and Order (January 12, 1987), ¶¶ 54, 83, 84, 94.

[153] The regional companies will generally prefer to conduct most nontelecommunications businesses in corporate entities (either subsidiaries or divisions at the parent company level) that are separate from the telephone companies. There is no reason, however, why this should be a waiver requirement. The Court did not impose such a condition when it authorized the BOCs to enter the CPE and Yellow Pages businesses. The Bell Atlantic telephone companies still publish their Yellow Pages directories and this has benefited Bell Atlantic's ratepayers.

The Department's Report and Recommendation is free of selfish bias: it recommends the elimination of all barriers to competition -- both those that favor the BOCs and those that restrict them. The spirit of this recommendation is consistent with the Court's goal of a fully competitive telecommunications industry.

The Court's experiments with competition under the decree have all proven to be successful and beneficial to the public. Further, these benefits have been realized without any adverse effect on telephone service.

The time has now come, as the Court foresaw, to determine whether additional progress can be made.

The record presently before the Court fully supports the conclusion that there is no substantial possibility that lifting the line of business restrictions will harm competition.

The requested relief, therefore, should be granted.

Respectfully submitted,

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April 27, 1987

CERTIFICATE OF SERVICE

I certify that on this 27th day of April, 1987, copies of the foregoing Bell Atlantic's Motion for Leave to File a Memorandum in Excess of 45 Pages, Motion of Bell Atlantic to Remove Portions of the Line of Business Restrictions Contained in the AT&T Consent Decree, and Memorandum of Bell Atlantic in Support of Motion to Remove Portions of the Line of Business Restrictions Contained in the AT&T Consent Decree were served by first-class, United States mail, postage prepaid, upon the parties to this action.

James R. Young

James R. Young
Attorney for Bell Atlantic

ANTITRUST SUBCOMMITTEE
OF THE
SENATE JUDICIARY COMMITTEE

APRIL 30, 1987 HEARING ON THE PROPOSED
MODIFICATIONS TO THE AT&T DIVESTITURE DECREE

STATEMENT FOR THE RECORD OF
NYNEX CORPORATION

EXECUTIVE SUMMARY

It is now almost five years since the Court approved the agreement that the American Telephone and Telegraph Co. ("AT&T") and the Department of Justice ("Department") entered into and which resulted in the Modification of Final Judgment ("MFJ" or "decree").

The decree provided in part that the divested Bell Operating Companies would be prohibited from providing interexchange telecommunications, information services, manufacturing telecommunications products or customer premises equipment, and providing any other products or services -- except exchange telephone communications service and exchange access service -- which are not natural monopoly services actually regulated by tariff.

In its decision approving the agreement, the Court was mindful that rapidly changing technological developments and/or changes in the structure of the market could soon obviate the need for continuing the line of business restrictions. The Court further observed that by continuing the restrictions beyond the point that they were required, "their sole effect would be to limit competition by preventing the entry of a viable competitor." To avoid such a result, the Department of Justice undertook to report to the Court every three years on the continuing need for the restrictions imposed by the decree.

The Department submitted such a report to the Court on February 2, 1987.

The report is based in part upon a factual study of competition in the telecommunications industry made by Peter Huber, a lawyer and former engineering professor at the Massachusetts Institute of Technology. He made the study while serving as a consultant to the Department. Dr. Huber studied the industry for almost a year, soliciting the views of telecommunications companies, consumer groups, and regulators.

In its February 2 report to the Court the Department recommended that the Court remove most of the restrictions on the divested companies. Specifically, it urged that the MFJ prohibition on information services, manufacturing, providing interexchange services entirely outside one's own region, and providing nontelecommunications products and services be lifted. In addition, the Department recommended regional companies be allowed to provide mobile services outside their regions.

The Department's Report documents the speed at which changes in technology, market forces, industry structural and regulatory activities have been occurring since the MFJ was signed. The Department has presented a factual analysis of the state of the industry today. It has applied the appropriate standard of review to those facts and has come to sound conclusions which form a solid basis for action by the Court.

The line of business restrictions on the seven regional companies should be removed. The beneficiary will be the American public, who find many information-age products and services now available in a practical way to only a small segment of our population. This is because manufacturers of telephone equipment and providers of information services want to market not to small businesses and individuals, but to large users with more money to spend. If allowed, NYNEX, with its long history and commitment to serving its customers, could bring information services, for example, to users of the network at a price made affordable by the economies of scale.

In fact, the study leading to the Department of Justice's recommendations highlighted that the immediate beneficiaries of enhanced network information services can be the elderly and the disabled.

The same technical elements of a sophisticated telephone network that make "911" emergency services possible could be used to bring a host of other timesaving, energy saving and indeed possibly lifesaving services to all Americans.

Consider the benefit to our citizens of universally available and reasonably priced alarm services, home energy management services, voicemail for parents to use in communicating with "latchkey" children, or fo loved ones to use in reminding the elderly to take medicines, visual form voice communications for the hearing impaired, electronic yellow page assistance for the blind, and so forth. The list can go on and on, but not until the regional companies are allowed and incented to do the research and development to explore the many possible new services which could make life easier and safer for all Americans.

To permit seven American companies with combined assets of over $150 billion into information services, manufacturing and long distance services, with appropriate safeguards against cross-subsidy and discriminatory treatment vigorously enforced, can only serve to pump up the American economy and help to renew our leadership position in the worldwide information industry. Conversely, to continue to prevent these companies, which represent about 2/3 of America's telecommunications resources and know-how, from providing these services, may well result in America losing our global leadership role.

We are aware there are those who oppose our entry into certain markets. They include those now offering some information services, some long distance companies, and some manufacturers.

But we believe that Congress should not condone the granting of special protection to some American businesses while holding others back. Congress should support open opportunities for all American business, to promote and nurture the delivery of new services to our citizens.

Some people ask for a guarantee that lifting these restrictions will bring immediate innovation in specific areas at a certain price to certain citizens. Without the freedom and the incentive to research, the companies cannot even begin to draw up that list, much less develop and refine it based on the needs of the marketplace. But it is important to have a vision - to further the precepts of our founding fathers by making innovation an approved behavior rather than a punishable one. Government should give our scientists and technicians inspiration to look into the future, not to see things as they are and ask why, but rather to dream things that never were and ask why not.

In summary, NYNEX believes the time is right for lifting of the line of business restrictions imposed on the seven regional holding companies by the MFJ. We urge the Subommittee to be mindful of the benefits to the average American and to the nation's economy that such an action could bring.

NYNEX SUPPORTS THE LIFTING OF RESTRICTIONS ON THE REGIONAL COMPANIES

What has Changed?

Doubtless a number of "Why Now?" questions will be raised during the Committee's hearings by persons with a direct business interest in keeping the seven regions out of specific activities. It will be said that "the ink is hardly dry on the decree" or that "more time" is needed for current struggling participants in these lines of business to solidify their competitive positions. It is predictable that those who are in a certain business want to keep others out. But is it Congress' desire to give special protection to some companies while holding others back? We think not - instead, we think the challenge for Congress is to open opportunities for all, within a framework of full and fair competition, so that the delivery of new services to our citizens and healthy economic growth will be promoted.

Let us then focus for a bit on fundamental industry and regulatory changes which have occurred since divestiture:

First and foremost is that we have essentially achieved the goal of offering to competing service providers the same equal access to our network which was once enjoyed only by AT&T.

Second, there is no longer a unified Bell System, but instead there are seven companies pursuing their own independent goals. The Court and federal and state regulators now have "benchmarks" to judge the actions of any one region, and the public has new watchdogs who, because they are current or potential competitors, have a strong business interest in being part of the system guarding against anti-competitive behavior in the telecommunications marketplace.

These changes are extremely significant and important in reviewing the appropriateness of continued line of business restrictions.

Equal Access

Implementing equal access has been an extraordinary undertaking unparalleled in the communications industry in terms of labor, expense and capital investment. This is particularly true for the NYNEX Telephone Companies. At divestiture, only 47 percent of the 12.8 million network access lines in service in our region were served by electronic stored program control ("SPC") switching systems. This number was by far the lowest percentage of all the regions. Nevertheless, the commitment and dedication of resources made by NYNEX has transformed equal access from a goal to a reality.

Through December 31, 1986, the NYNEX Telephone Companies converted 445 offices and eight million lines to equal access. To better meet the carriers' marketing needs, NYNEX concentrated its conversions in two key market areas, Manhattan and Boston. Thus, 80 percent of the access lines in the Manhattan business area and 78 percent of the access lines in the metropolitan Boston area now have equal access capability. NYNEX has converted all of its conforming SPC switches and far more nonconforming offices and lines to equal access than any other region.

Our progress towards ubiquitous equal access is moving forward on schedule and NYNEX is committed to a three billion dollar switch replacement program which will result in full equal access service in 100 percent of its offices no later than the end of 1992, (and even earlier in our two key market areas of Manhattan and Boston, which will be completed in 1989). Our equal access program will result in 100 percent equal access eight years earlier than we forecasted when the NYNEX Equal Access Plan was filed with the Department back in April 1984.

In just a few years, NYNEX will have completed the reconfiguration of its network -- a network originally configured for a single carrier that took decades to build -- into an equal access network that provides exchange access to multiple carriers and information providers for multiple services. The Department is correct in its assessment that the equal access requirements of the decree have been met and that equal access is a "reality."

Significant Market Structure Developments

Two results of divestiture bear emphasis. First, any theoretical opportunity that NYNEX could discriminate against competitors or cross-subsidize competitive services with revenues derived from monopoly services has been effectively eliminated. When there was an integrated Bell System, courts and regulators had practically no opportunities to develop "benchmarks," that is, means for comparing the actions of AT&T, or the individual Bell System Operating Companies. Without such benchmarks, there was no uncomplicated and ready test for uncovering anticompetitive conduct. Divestiture changed all this. There are now seven independent companies. A firm, constant and readily available basis exists for comparing the actions of any one against the actions of another.

Second, few expected five years ago that the regional companies and AT&T, as well as other providers of communications services, would become the vigorous rivals they have become. AT&T, as the principal supplier of divested telephone company switches and other facilities, is clearly in a position to know the capabilities of these facilities. Also, AT&T has in-depth knowledge on the development of tariffs, and the necessary cost support data which must be filed with the FCC and state commissions. AT&T is thus fully capable of identifying and uncovering issues of discrimination and cross-subsidization, and indeed has a compelling business interest in being vigilant against any such activity.

In addition, there are others who are now actively engaged in providing complete communications services, such as IBM, General Electric, General Motors, and the Boeing Company, to name a few. These companies are capable of quickly responding to any hint or appearance that a competitor may be engaged in discrimination, or may be cross-subsidizing a service. The rivalry of these well financed competitors in regulatory proceedings has served to enhance the effectiveness of the regulatory process.

In addition to equal access conversions and market structure changes, new regulations are being put into place which will further protect users from discriminatory treatment and consumers from any fear that telephone ratepayers might finance new unregulated ventures.

Significant Recent Regulatory Developments

For those who may still feel discomfort in granting line of business freedom to the companies, attention should be called to new FCC regulations which effectively prevent any attempted cross-subsidy or discrimination on the part of the regional companies. Foremost among these are the FCC's recently promulgated Computer III Rules. These rules are designed to meet the FCC's objectives of preventing discrimination and cross-subsidization, and insuring equal access for information service providers, which is defined in terms of technical comparability and price equality.

Should our telephone companies wish to offer an enhanced service, they must currently comply with the Comparably Efficient Interconnection (CEI) requirements and other nonstructural safeguards established in Computer III. Those requirements insure that, in circumstances where integration makes discrimination theoretically possible, stringent regulatory requirements make it nearly impossible to achieve. These measures include equal access, unbundling, and minimization of transport costs, as well as nondiscrimination in installation, maintenance and repair. In short, there is in place a regulatory regime which ensures that the regional telephone companies are unable to favor their own services to the detriment of competitors.

Those regulatory requirements also must be met in the Open Network Architecture (ONA) plans to be filed by the regional companies by February 1, 1988. Those plans are also required to reflect industry input on the type of interconnection arrangements which should be offered. NYNEX is committed to working with the enhanced service providers in developing a plan which will ensure effective implementation of the Commission's ONA directive.

In addition to ONA and CEI, various other nonstructural safeguards have been promulgated by the FCC to prevent those abuses feared by parties who resist the removal of the information services restrictions. The other nonstructural safeguards are: (1) the filing of non-discrimiation compliance plans; (2) disclosure of network information; (3) access to customer proprietary network information (CPNI); (4) the filing of Quarterly reports; and (5) allocation of joint and common costs. These regulatory safeguards will afford significant protection to those parties who unnecessarily fear the position of the BOCS in the marketplace.

The FCC's Joint Cost rules will preclude any substantial possibility of divested telephone company cross-subsidy of nonregulated services, including information services, that could impede competition.

The Joint Cost rules have been promulgated to "inhibit carriers from imposing on ratepayers for regulated interstate service the costs and risks of nonregulated ventures". The rules adopt an attributable cost method of fully distributing costs. That is, nonregulated services will be attributed with all costs having a direct or indirect casual connection to the services, and will also receive an allocation of joint and common costs in proportion to the direct and indirect cost attribution. All nonregulated service costs will be removed from the regulated ratemaking process.

The FCC has also mandated that the companies file cost allocation manuals conforming to the Joint Cost rules. The manuals will be subject to public comment as well as attestation by an independent auditor and finally FCC approval. It is clear that FCC regulation imposes a strict and stringent standard that effectively prevents cross-subsidy or discrimination.

Significant Technological Changes

In its report recommending the lifting of the MFJ restrictions, the Department also noted other significant technological changes, such as the dramatic advances in digital switching technology for on-premises switching systems. As a consequence of this technological change, and as Dr. Huber found, "a business user's dial tone is more likely to be generated by a private exchange than by a public one." Another significant change is that interexchange carrier switches now are capable of providing dial tone. Hence, interexchange carriers are in direct competition with switching services formerly provided exclusively by local exchange carriers.

What Test Must be Met to Qualify Regions for Freedom from MFJ Line of Business Restrictions?

Section VIII(C) of the MFJ provides:

> The restrictions imposed upon the separated BOCs by virtue of section II(D) shall be removed upon a showing by the petitioning BOC that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter.

This provision was added to the MFJ by the Court when it approved the MFJ in the expectation that:

> It is probable that, over time, the Operating Companies will lose the ability to leverage their monopoly power into the competitive markets . . . as a result of technological developments which eliminate the Operating Companies' local exchange monopoly or from changes in the structures of the competitive markets. In either event, the need for the restrictions . . . will disappear, and the decree should therefore contain a mechanism by which they may be removed.

At that time, the Court noted that the Department would be providing a three-year report on this subject -- as it has now done -- and explained that the existence of Section VIII(C) would "avoid any question about the appropriate test" to be applied because "the standard for removal of the restrictions . . . [would be] explicitly incorporated into the decree."

The Department has correctly analyzed the relevant precedents: "Neither third parties nor a party to the decree has any right to prevent the removal of decree restrictions once the express decree standard for their removal has been satisfied." Therefore, as the Department has pointed out, the question is whether "it is likely that the BOC would be able, through discrimination or cross-subsidization, to gain sufficient power in the [entered] competitive market to impede competition and raise prices," bearing in mind that the restrictions "themselves may have anticompetitive effects and impair efficiency," and that the "theoretical possibility of anticompetitive conduct" should not bar entry under this standard. As the Department further noted, it is not "necessary that all possible competitive risks be eliminated entirely," so long as "technological or competitive conditions have eliminated any significant practical risk that particular BOC activities will impair competition."

In considering the Department's recommendations, the Subcommittee should bear in mind that the provision for this review was an integral element of the MFJ, reflecting the expectation of the Court that market conditions and technology would undergo rapid change. This was to be a comprehensive, fresh look at the divested companies' participation in the broadly defined markets identified in the decree. In this context -- and in view of the dramatic developments in the intervening years that are shown by the Huber Report -- it should be recognized that the trial record in the AT&T divestiture case, now more than five years old, is no longer a reliable portrayal of the realities of the industry. It is, of course, historical background, but it is not a sound basis for judging the Department's recommendations.

Now let us discuss in detail the recommendations of the Department according to line of business categories:

INFORMATION SERVICES

The prohibition on the provision of information services should be lifted. Section IV(J) of the decree defines an "information service" as:

> The offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information which may be conveyed via telecommunications, except that such service does not include any use of any such capability for the management, control, or operation of a telecommunications system, or the management, control, or operation of a telecommunications service."

The actual restriction on the furnishing of information services by the divested companies is found in Section II(D) of the decree.

In hindsight, the information services bargain struck at divestiture is difficult to understand. The trial record did not include any allegations of discrimination against information service providers. At the same time, it must be recognized that in 1982 the services fitting within the decree definition of information services were at an early stage of technological and competitive development. This factor may have been important in the minds of those who crafted the restriction and to the Court's decision to approve it. Whatever the justification may have been for the prohibition in 1982, it is, in Dr. Huber's words, "undoubtedly true and clear today" that the restriction is unnecessary to protect competition.* As Dr. Huber succinctly observes, "the Bell System, old or new, could no more monopolize today's electronic information service markets ... than it could monopolize wheat farming by growing grain along telephone-pole rights of way."**

The information services prohibition clearly serves severely to limit NYNEX's ability to meet the full needs of its customers. It has resulted in some services being offered in an inefficient way and others not being offered at all, even though technology to provide them, and demand for them, exist. Finally, the prohibition denies to ordinary citizens of this country the array of services available to citizens of other countries.

The restriction can be removed without fear of anticompetitive effect. There is no substantial possibility that discrimination or cross-subsidization will be a problem if the regions are permitted to provide these services.

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* Huber Report at p. 120.

** Id.

We agree with the Department of Justice that there should be relaxation of the restrictions on the offering of information services, and on services not connected to telephone services.

Information services for which there is no potential for discrimination are those offered by the divested companies outside of their regions. The Department appropriately concludes that "there would be little risk of anticompetitive effect on information services markets if extra-regional information services were offered by the BOCs."* Considering the vigorous competition now developing between them, the likelihood of one region providing another advantages in interconnection for information services is non-existent. There is, of course, absolutely no opportunity for a region to use its own local exchange network to favor itself over other information service providers not connected to telephone service. The Department discusses services which utilize tapes or disks to store information in magnetic or optical form in a local processing unit.** Consideration of such "stand-alone" services is important to the reassessment that there is no longer any need for the decree restriction. Just a few years ago, access to local exchange facilities was the only practical means of accessing large databases. Large users now have other choices. Computer storage media have become more sophisticated and the price of computer memory capacity has dropped dramatically. It is practical and efficient to locate many databases on the premises of the user.*

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* Department Report at pp. 123-125.

** Id. at p. 127.

There is little opportunity to incur joint costs between the NYNEX Telephone Companies and extra-regional information services operations. The telephone companies simply have neither personnel nor facilities in other parts of the country available to share with affiliates. The impracticability of sharing means that NYNEX market entrants outside the region cannot gain an advantage by cross-subsidizing. The VIII(C) standard is clearly met and the restriction on extra-regional services should be removed.

NYNEX now offers equal access to all information providers and would itself use these same arrangements to provide virtually all information services on a non-integrated basis.

There are some electronic information providers that use services provided by the divested telephone companies under tariff. The degree and type of that use vary from service to service. With respect to each user, NYNEX provides telecommunications services on equal terms and conditions. The rapid growth in the information services market is testimony to the fact that a vast number of information services can be efficiently offered without integration into divested telephone company switches. If permitted into the information services market, NYNEX entrants would be required to obtain these services from the telephone company on the same terms and conditions as are applicable to all customers. There will be no advantage vis-a-vis competitors.

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* The network is still employed when continuous updates to the data are critical, or when the user wishes to interact with a remote computer (i.e. both receive and send data in real time). In such cases, however, the role of the BOC network may be limited to providing basic tariff access to other networks.

For most providers of information services, divested telephone company facilities are a small component of their business, in both the technical and economic sense. Particularly where the connection is a dial-up one initiated by a customer, the NYNEX Telephone Companies have little, if any, knowledge about the type of traffic being generated by the numerous and diverse users of the network. They have no way of knowing which of the thousands of calls made over dial-up lines are calls to information service providers. Many of these calls link the end user directly into an information provider's network node, so that all but the access line connection uses a private or value-added network.* These are typically simple connections, with short holding times per communication, offered pursuant to tariff, and cannot be realistically manipulated to favor one information service provider over another.** In order

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* The more sophisticated network services utilized in value-added networks (VANs) are purchased from AT&T, MCI and other interexchange carriers. These companies may offer information services in competition with their VAN customers, provided they comply with FCC regulations.

** The transaction services market is an illustration of the way in which BOC services are used. When a customer makes a credit card purchase at a store, the merchant typically checks to see if the card is valid by

(FOOTNOTE CONTINUED ON NEXT PAGE)

to discriminate, NYNEX would have to disrupt and restructure its local exchange network. Not only would this be impractical and self-destructive, it would be easily detectable.

The more utilization that information service providers make of the telephone network, the more revenue for the NYNEX Telephone Companies. This is a clear economic incentive to ensure non-discriminatory, quality service. Particularly in light of alternative means of access now available in the information industry due to developments in technology, discrimination would be obviously counterproductive.* The Department recognizes that the regions will strive to retain the business of information service providers,** and concludes that there is no significant risk of discrimination in the provision of information services by the regions when the local exchange facilities used are equally available to other providers.

FOOTNOTE ** CONTINUED:

contacting a transaction service provider. This connection can be by direct dial-up, private line, 800 service, or most commonly through a dial connection to a packet network with local nodes in many cities. When the transaction services provider receives the inquiry, it performs protocol conversion and message reformatting and sends the information over yet another network to the card issuing bank, where the inquiry is checked against the bank's files. The second network is often a private network as well. The response (valid or invalid) is then sent in the other direction, first to the transaction provider, and then to the merchant.

* Department Report at p. 128.

** Id. at pp. 128-29.

The final group of services examined by the Department are those that "can most efficiently be provided at the level of the switch, i.e., on an integrated basis."* Here, the Department recognizes that there is a risk, but concludes that the very significant public benefits to be gained dictate that the regions should be free to offer integrated information services under regulatory supervision.

We agree with the Department that certain services can best be offered on an integrated basis. These are few in number when compared to the overall information services picture. However, for residential and small business customers that small part may become significant. Integrated technology thus represents a means of providing new services which otherwise would not be available to the public.

NYNEX Has No Incentive or Ability to Discriminate and Impede Competition in the Information Services Market

The Federal Communications Commission has in place a set of regulatory requirements which make the possibility that the BOCs would be able to impede competition in the information services market remote. Under the Commission's Computer II rules (47 CFR § 64.702) enhanced services (and, were the BOCs permitted to offer them, information services) may be offered through a structurally separate subsidiary.* Any telephone company services required for those offerings would have to be obtained under tariff and be available to competitors on the same terms.

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* Department Report at p. 113. NYNEX assumes that the services which the Department terms "integrated" do not include those merely colocated with, but separate from, BOC basic service equipment. Network interfaces for colocated services can be clearly defined and offered to all parties under tariff.

The Commission, as the Department observes, has now modified its Computer II rules. The Commission's objectives, however, remain essentially the same. And those objectives are virtually identical to those of the Department:

- to prevent discrimination;
- to prevent anti-competitive cross-subsidization;
- to ensure equal access, which is defined in terms of technical comparability and price equality.

The regulatory structure adopted by the Commission ensures that adequate controls are in place now to fully meet those objectives.

Should the NYNEX Telephone Companies wish to offer an enhanced service, they must currently comply with the Comparably Efficient Interconnection (CEI) requirements and other nonstructural safeguards established in Computer III. Those requirements ensure that, in circumstances where integration makes discrimination theoretically possible, stringent regulatory requirements make it nearly impossible to achieve. These measures include equal access, unbundling, and minimization of transport costs, as well as nondiscrimination in installation, maintenance and repair.* In short, the regulatory regime which ensures that the NYNEX Telephone Companies are unable to favor NYNEX services to the detriment of competitors is in place.**

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* "Enhanced Service" is defined by the FCC to include "services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code protocol or similar aspects of the subscribers' transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 C.F.R. § 64.702(a). The question of whether the MFJ definition of information services is substantively identical to this FCC definition has never been definitively resolved. It is clear, however, that the two are substantially equivalent for all purposes relevant to this proceeding.

The crucial fact here is that the current regulatory regime operates to meet the objectives of the decree. The consistent theme of this regime is to permit activities which enhance the efficiency of the network, and hence consumer welfare, while insisting on safeguards against potential anticompetitive behavior by carriers. Therefore, the current and prospective regulatory regime will ensure that the information services prohibition is unnecessary to protect competition.

NYNEX Has No Incentive or Ability to Cross-Subsidize

Previous comments explain that the possibility of NYNEX discriminating against competitors in the information industry is minimal. An analysis of the restriction must also assess whether BOC entry will impede competition through cross-subsidization. This potential is insubstantial. Divestiture has provided the courts, regulators and the industry with an important standard by which to judge whether a BOC is engaging in cross-subsidization. That standard is the costing and pricing behavior of the other six BOCs and AT&T -- benchmarks against which any one BOC can be judged. What was a unified entity when the information services restriction was imposed is now a fragmented set of highly individualized communications companies. In areas such as directory, CPE and intraLATA networks, those companies, formerly Bell System Companies, including AT&T, compete aggressively with one another. The pattern should not prove to be any different in information services, where the activities of each BOC in the area of cost allocation will be closely scrutinized by its former affiliates, as well as other large market participants. Any attempted cross-subsidization will be policed and detected.

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* Report and Order, CC Docket No. 85-229, Phase I, released June 16, 1986 at ¶¶154-166 (Computer III Order).

** Those same requirements must be met in the Open Network Architecture plans to be filed by February 1, 1988. Those plans are also required to reflect industry input on the type of interconnection arrangements which should be offered. NYNEX is committed to working with the industry in developing a plan which will ensure effective implementation of the Commission's ONA concept.

The Department's finding on this subject is correct.* The FCC's Joint Cost rules** will preclude any substantial possibility of divested telephone company cross-subsidy of nonregulated services, including information services, that could impede competition.

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* Department Report at pp. 133, 143.

** In the Matter of Separation Of Costs Of Regulated Telephone Service From Costs Of Nonregulated Activities, CC Docket No. 86-111, FCC 86-564, Report and Order adopted December 23, 1986, released February 6, 1987 ("Joint Cost Order").

The Joint Cost rules have been promulgated by the FCC to "inhibit carriers from imposing on ratepayers for regulated interstate service the costs and risks of nonregulated ventures".* The rules adopt an attributable cost method of fully distributing costs. That is, nonregulated services will be attributed with all costs having a direct or indirect causal connection to the services, and will also receive an allocation of joint and common costs in proportion to the direct and indirect cost attribution. All nonregulated service costs will be removed from the regulated ratemaking process.

The FCC has also mandated that BOCs file cost allocation manuals conforming to the Joint Cost rules. The manuals will be subject to public comment as well as attestation by an independent auditor and finally FCC approval. It is clear that FCC regulation imposes a much more stringent standard than the Section VIII(C) antitrust analysis would require.

INTEREXCHANGE SERVICES

The MFJ's ban on the regional companies' provision of interexchange services was based on the assumption that local exchange facilities were "bottlenecks." Since a divested telephone company does not have any local exchange facilities outside of its region, we agreed with the Department's February 2, 1987, conclusion that the regional companies should be permitted to provide interexchange services entirely outside of their regions.

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* Joint Cost Order, para. 1.

The Department's conclusion was that there is "no substantial possibility" that the regional companies could impede competition in the provision of interexchange service outside of their regions and in the provision of interexchange mobile services was a sound one. Interexchange services do not constitute a homogeneous market. Rather, there are different markets with different levels of dependence on access to local exchange carrier facilities. There is the market for message telecommunications service ("MTS") provided to small users which is dependent on local exchange access. There are also markets which are largely independent of local exchange access such as, for example, the international dedicated services market, and the highly competitive large business customer market. Section VIII(C) provides that the MFJ line of business restrictions shall be removed upon a showing that there is no substantial possibility that a divested company could use its monopoly power to impede competition in the market it seeks to enter. Because of the extreme variations in the facts regarding the interexchange market, the application of the Section VIII(C) criteria should remain the appropriate way for judging the continued efficacy of the remaining MFJ restriction in specific interexchange markets.

We agree with the Department's February 2, 1987, recommendation that NYNEX should be allowed to provide interexchange service outside its region. When it approved the MFJ in 1982, dealing with the MFJ restriction on the divested companies providing interexchange services, the Court noted that the divested companies were in a position to "provide to their own interexchange services more favorable treatment than granted to the other carriers." Of course, in providing interexchange services outside of its region, there could not be any use by that region of its local exchange "bottleneck" facilities. In other words, a regional company could not possibly leverage control of local exchange "bottleneck" facilities to impede competition outside of its region.

The Department rejects a claim, which may be made, that the regions as a group would act to favor each other. The regional companies "have become independent companies willing and able to compete against each other."* As we have noted earlier in this filing, each of the regions serves as a check and benchmark on the conduct of any one region. Also, the divested companies and AT&T are often arrayed against each other as competitors. This significant development has enhanced the effectiveness of federal and state regulatory agencies.

We agree with the Department's recommendations on the provision of interexchange mobile services.

The Department recommends that the interexchange services restriction should no longer be applied to the mobile radio services (cellular, conventional mobile telephone, paging, and other specialized services) provided by the regions.** As the Court has recognized, LATA boundaries were drawn with respect to landline calling patterns, and they do not reflect natural mobile services markets.* The Department is correct in its observation that mobile radio sevices are subject to robust competition, and that the competition is with other mobile services providers, rather than with the interexchange carriers.** The amount of traffic carried by mobile services across LATA boundaries is miniscule compared to total non-mobile interLATA traffic in the same area. Moreover, due to the high price of mobile telephone equipment and airtime charges, mobile telephone service is not generally considered to be a cost-effective substitute for other types of telephone services. Enforcement of LATA boundary restrictions on mobile services is not necessary to protect interexchange competition.

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* Department Report at pp. 74-75.

** Id. at pp. 77-78.

The Department is correct in its observation that the interexchange services prohibition, when applied to mobile services, "has the potential to impede mobile network efficiency at some cost to the public."*** Because LATA boundaries do not reflect natural mobile services markets, the interexchange services prohibition, if not waived, requires the construction of additional switching facilities and artifical segmentation of service areas. The history of NYNEX Mobile Communications Company's ("NYNEX Mobile") New York LATA waiver request is a good example of how unnecessary prohibitions can have a negative effect on competition, even where procedural avenues for relief are available.* Therefore, we favor the Department's recommendation lifting any restriction on the regional companies from providing mobile services without regard to LATA boundaries.

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* United States v. Western Electric Co., supra, 578 F. Supp. at 648-49.

** Department Report at p. 77.

*** Id. at p. 78.

We believe that the Department's recommendation on interexchange services within a region should be made more flexible.

The Department recommended on February 2, 1987, that the MFJ restriction on the provision of interexchange services originating or terminating within the region be retained since the local telephone companies arguably have significant bottleneck power with respect to interexchange services. The Department contends: "state [regulatory] restrictions currently give the BOCs significant anticompetitive advantages in the provision of interexchange services originating or terminating in their regions."** Accordingly, the Department has proposed that, in evaluating requests by a regional company to provide interexchange services originating or terminating within its territory, the Court apply certain criteria in determining whether a LATA is free of regulatory barriers to competition.*

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* NYNEX Mobile was prevented from expanding its New York/New Jersey metro cellular system to the eastern Long Island, southern Connecticut, Long Branch and New Brunswick areas for two years during the processing of its waiver request. While the Court ultimately granted the waiver request, procedural delay alone caused the public to be denied the benefits of mobile services in these expanded areas.

** Department Report at p. 35.

The Department's criteria are designed both to provide the regional companies and state regulators with an incentive to adopt procompetitive policies and to provide specific guidance as to the circumstances which would be considered in evaluating those policies for decree purposes.**

NYNEX's commitment to competition is long standing. Key NYNEX officials have made this clear in public statements as well as in company filings before the FCC and in state commission proceedings in our region. Indeed, the state commissions in this region have been in the forefront in advocating the role of competition in telecommunications. Facility as well as resale intraLATA competition is sanctioned on a broad scale. Thus, currently, competitors may provide intraLATA facility and/or resale telecommunications services to over 90 percent of our customers.

Interexchange services originating or terminating in an exchange area are not uniformly dependent on local exchange carrier access. Rather, there are different markets and the VIII(C) standard can be met in specific markets and can be met in a variety of ways. Removal of all regulatory barriers to entry and resale is not a necessary condition for meeting the VIII(C) standard for significant portions of the interexchange market.

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* Department Report at p. 98.

** Id.

Interexchange Services Are Not Monolithic With Respect to Their Dependence on Access Provided by Local Exchange Carriers

The telecommunications market is not a homogeneous or monolithic one. The market includes a wide range of services to meet the varied needs of different users. For example, high capacity data transport and switching services for large businesses are available from multiple sources. Dr. Huber calculated a "Bottleneck Index"* for various classes of interexchange services. The value of this index covers a broad range, from 1.0 for message telecommunications services ("MTS"), 0.1-0.2 for direct connect interexchange services to 0 for end-to-end private line facilities. Clearly, a showing that the VIII(C) standard is met would be different for these different classes of service. Meeting the VIII(C) standard for MTS service and end-to-end private line facilities will call for different proof. To apply a single set of criteria for "all or nothing" removal of the prohibition on interexchange services within the region would ignore the reality of the interexchange marketplace.

A proposal to provide a high capacity interexchange private line service within a region, or even internationally, could be shown to meet the VIII(C) standard for a particular market by proof that competitive alternatives exist within that market that do not depend on local exchange carrier access from the local exchange company. Second, a showing could be made that these interexchange services would involve minimal joint or common costs with local exchange service and that local exchange carrier access would be obtained on the same terms and conditions as are available to other vendors. Under these circumstances, the VIII(C) standard may be met by showing that there is "no substantial possibility" that it could "impede competition" in the interexchange market.

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* *See* Huber Report, table IX.5. The Bottleneck Index is the ratio of the local exchange carrier's revenue to the interexchange carrier's revenue for the particular service.

Changes in technology, customer needs and industry structure have resulted in a level of competition so that NYNEX does not have monopoly power in this relevant market. For example, such a showing could be utilized to demonstrate that the VIII(C) standard is met with respect to the provision of services to the large business user customers.

MANUFACTURING

The Department has taken a practical look at the current state of competition in all telecommunications manufacturing markets. The Department's recommendation, with which NYNEX agrees, is a necessary step forward in bringing the benefits of competition to the American consumer.

Rather than reiterate the points made by the Department and Prof. Huber, NYNEX will discuss the original rationale for the decree restriction and the key reasons why it should be removed.

The Decree Prohibition Has No Rational Basis

The MFJ prohibits the divested telephone companies from manufacturing "telecommunications products or customer premises equipment."* As the Court noted, the government's procurement portion of its case against AT&T was based on the rationale that:

> ". . . a combination of vertical integration and rate of return regulation . . . tended to generate decisions by the Operating Companies to purchase equipment produced by Western [Electric] that is more expensive or of less quality than that manufactured by the general trade."**

Accordingly, the purpose of the manufacturing prohibition was to eliminate the relationship between AT&T and its telephone companies, jointly responsible for buying about 80 percent of the telecommunications equipment and CPE purchased in the United States, on the one hand, and Western Electric, wholly-owned by AT&T and responsible for manufacturing about 80 percent of the telecommunications equipment and CPE used in the United States, on the other hand.

The Department believed that these relationships gave Western Electric an unfair competitive advantage. It alleged that AT&T established performance and interconnection standards which were then used to exclude the products of manufacturers other than Western Electric. Once this exclusion process began, the Department alleged, it became almost impossible to stop. Western Electric's products, once established in the network, set the standards other products had to meet. It was further alleged that Western Electric, because it produced a very wide variety of products, could and did set its prices to impede competition as to specific products of outside manufacturers. And, finally, it was alleged that AT&T and the AT&T telephone companies purchased essentially all of their major product needs from Western Electric, thereby preventing significant competition from ever developing.

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* MFJ § II, D, 2. Telecommunications products consist of equipment which "is used by a carrier to provide telecommunications service." United States v. American Telephone & Telegraph Co., supra, 552 F. Supp. at 190.

** United States v. American Telephone & Telegraph Co., supra, 552 F. Supp. at 190.

The validity of these contentions was highly questionable. In any reasonable analysis of the enormously complicated trial record, two clear conclusions must stand out:

(1) if the government's contentions were correct, the combination of both a producer monopoly and a purchaser monopsony, working together to exclude competition, and without any effective interference from regulators, manufacturers, standards bodies or other carriers, should have effortlessly been able to foreclose all competition; and

(2) no such thing ever happened.

As the Court noted, the government's proof in the manufacturing section of the case was relatively weak, and covered only a small portion of AT&T's procurement activities.* Moreover, the government failed utterly "to prove any of its contentions regarding anticompetitive [equipment] pricing."* Its equipment pricing allegations were stricken even prior to defendants' presentation of any evidence.** The allegedly seamless monopoly/monopsony thus didn't exist even prior to divestiture.***

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* See United States v. American Telephone & Telegraph Co., 524 F. Supp. 1336, 1372, n.154, and n.155 (D.D.C. 1981).

If AT&T could not manipulate its alleged monopoly/monopsony to substantially impede manufacturing competition prior to divestiture, no single BOC, with a zero percent manufacturing share and perhaps 10 percent purchasing share, could now possibly impede competition -- much less substantially impede competition.

Allowing The Regional Companies To Manufacture Will Benefit Both Consumers And The Economy

Large manufacturers of telecommunications equipment typically have multiple customers with conflicting needs, often including a "preferred" internal customer. Some manufacturers' schedules are determined not only by the manufacturer's legitimate business interests, but also by the business interests of a carrier affiliate which may compete with the regional companies. The resulting decision (i.e., by the combined manufacturing/carrier entities) may not be favorable to production of the equipment needed by the regional companies' customers. As a result, the regional company is unable to decide itself what services to offer to its customers, or when to offer them. Inevitably, customers suffer.

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* Id. at 1380.

** Id. at 1381.

*** One telling fact mentioned in the Huber Report is that AT&T's PBX market share fell from almost 70 percent in 1979 to under 30 percent in 1982. See Huber Report at p. 16.5.

NYNEX's ability to obtain the equipment and services it needs in a timely fashion would be significantly enhanced if NYNEX were to be enabled to engage in manufacturing activities and join with other manufacturers as needed. Only in this way will NYNEX's customers be assured full and timely access to the products and services.

Moreover, elimination of the manufacturing restriction will permit NYNEX to offer higher quality products and services in several ways:

(1) Participation in the full product cycle from design and development* to production will result in products which ideally suit NYNEX customers' unique needs.

(2) Quality assurance of critical products often requires a closer association than conventional contractual agreements between purchasers and suppliers permit.

(3) Prudent policy may induce NYNEX to develop a second source of supply for key items.

Products will be Better Suited to the Needs of NYNEX and its Customers

Both American and foreign manufacturers of communications equipment tend to develop products with large generic markets in mind. These products may fail significantly in meeting the needs of NYNEX's customers. For example, increased efficiency in the use of cellular radio bandwidth is of great concern in very few areas of the United States, but is crucial in New York. The need for extremely vandal-resistant public telephone handsets, needed for use in New York City, is another example.

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* BOC design and development of new products is, we believe, clearly permitted by the decree. However, controversy over the point persists, and "the Department has found it extremely difficult to draw a distinction" between permitted and prohibited manufacturing related-activities. See Department Report at p. 167, n.330. This lack of certainty inhibits BOC design and development activities.

Quality Assurance Often Requires a Closer Association Than Conventional Contractual Agreements Between Purchasers and Suppliers Permit

For essential products, conventional quality assurance agreements and processes tend to be insufficient.* To guarantee availabiiity of a certain quantity of reliable equipment by a given date may require a very close relationship, possibly including equity investment, between NYNEX and the manufacturer.

Prudent Policy May Induce NYNEX to Develop a Second Source of Supply for Key Items

Obtaining a second source for products currently available from only a single manufacturer may also require equity investment in a manufacturer. If the single existing manufacturer for a particular piece of equipment is considered dominant in this area, other companies may be unwilling to risk competition without a NYNEX investment assuming part of the risk.

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* One reason such conventional agreements tend to be insufficient is that, as the Huber Report points out, manufacturers are concentrated but purchasers are not. See Huber Report, p. 1.10. This inevitably means that manufacturers have some degree of market (not necessarily monopoly) power which enables them to avoid the strict quality assurance requirements buyers might wish to impose.

Moreover, even the potential availability of a second source tends to reduce the prices charged by a dominant manufacturer. The pricing of certain components which cost approximately the same to manufacture can vary greatly depending on whether the dominant manufacturer has any competition in manufacturing a particular component. NYNEX customers would certainly benefit if NYNEX were able to work freely with alternative, normally smaller, sources of supply to produce substitute products.

Finally, the economy would benefit from prudent investment by NYNEX in advanced technology. The absence of NYNEX and other regional companies from this investment arena significantly reduces the funds available within the United States for prudent investment in communications technologies. Further, the investment in communications by current American manufacturers tends to be heavily focused on products used by, or intended for, large business customers. Regional companies, which are required to serve all customers, would have a greater incentive to develop new products and services for use by the low-volume business and residence customers.

Design and development of new products by NYNEX would also improve the nation's technological capabilities, relative to foreign competitors.* Except for AT&T, the major manufacturers are in most cases foreign-based companies. In particular, product design and development is generally located in the home country of foreign manufacturers, even when the assembly and fabrication functions are located within the United States (Northern Telecom and Siemens are examples of this phenomenon). Thus, the technological and economic competitiveness of the United States can be improved if the BOCs are permitted to design, develop, and manufacture CPE and telecommunications products.

The Department has recommended that the prohibitions on regional company provision and manufacture of telecommunications equipment and manufacture of CPE should be removed. For the reasons stated, that recommendation should be implemented.

NONTELECOMMUNICATIONS BUSINESSES

In addition to the information and interexchange services and manufacturing restrictions, the MFJ also imposed on the regional companies a general line of business restriction which prohibits the provision of "any other product or service, except exchange telecommunications and exchange access service, that is not a natural monopoly service actually regulated by tariff."* The Department recommends immediate removal of the decree's general line of business restriction.**

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* The "international competitiveness" and "balance of trade" issues discussed in this paragraph are irrelevant to the Section VIII(C) standard for removing BOC line of business restrictions. See discussion in Section II, supra. Nevertheless, consideration of these issues only strengthens the rationale for removal of the manufacturing prohibition.

At divestiture it was argued by some that the general line of business restriction was "overbroad" and that the likelihood of the divested companies impeding competition in nontelecommunications businesses was unlikely. The Court rejected such arguments. The Court did, however, state that it would grant waivers to the divested companies allowing them to participate in nontelecommunications businesses upon a showing that they could not impede competition in the markets they seek to enter.

We now have had several years experience with the MFJ waiver process. The Court has acted favorably in over 100 general line of business waivers. As the Department observes, the process has been "costly and time consuming."*** Also, some competitors have used the process to improve their competitive position and denied consumers products and services by delaying entry by the divested company into a new market. The post-divestiture record stands as support for the Department's recommendation that the time has come to remove the nontelecommunications restriction.

As the Department observes, the post-divestiture experience establishes that there are no issues of discrimination associated with a divested company providing nontelecommunications products and services.* Similarly, the post-divestiture experience has demonstrated that misallocation of costs from a nontelecommunications competitive business to the regulated services provided by a divested company is extremely remote. There are no significant costs associated with nontelecommunications businesses that are common to the regulated businesses. To the extent that there are any joint costs which may be shared, improper allocation would not escape the scrutiny of federal and state regulators and, of course, competitors.

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* MFJ § II(D)(3).

** Department Report at p. 208.

*** Department Report at p. 207.

Lastly, NYNEX and the other regional companies are bound by the existing antitrust laws and other applicable commercial laws and regulations. There should be no doubt that, in a competitive marketplace, anticompetitive behavior would be quickly detected by competitors and the enforcement authorities. Therefore, there are adequate safeguards to govern the regional companies' conduct in nontelecommunication markets without the continuance of the MFJ restriction. NYNEX agrees with the Department's recommendation that the nontelecommunications business restriction should be lifted.

CONCLUSION

The Department's February 2, 1987 recommendations that the line of business restrictions be removed should be adopted with respect to:

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* Department Report at p. 207.

(1) information services,

(2) interexchange services entirely outside of a region,

(3) mobile services without regard to LATAs or original boundaries,

(4) manufacture of telecommunications products and customer premises equipment, and

(5) nontelecommunications products and services.

The Department's proposed criteria, or any modified set of criteria, should not be adopted as the exclusive Section VIII(C) test for removing the remaining MFJ restriction on the provision of interexchange services within a region.

STATEMENT OF
SOUTHWESTERN BELL CORPORATION
FOR THE
ANTITRUST SUBCOMMITTEE
OF THE
SENATE JUDICIARY COMMITTEE
APRIL 30, 1987

Southwestern Bell Corporation (SBC) is pleased to submit for the Subcommittee's consideration its statement concerning the line of business restrictions imposed on the Bell Operating Companies (BOCs) by the Modification of Final Judgment (MFJ) in the AT&T divestiture case and the Justice Department's Report and Recommendations with respect to these restrictions. That submission constituted the Department's first triennial report on the MFJ and was based on factual information presented by the Department's consultant, Dr. Peter Huber, in the Huber Report.

The Department found that, given the current structure of telecommunications markets and regulatory safeguards, most of the line of business restrictions imposed on the BOCs by the MFJ have become unnecessary and should be removed. SBC agrees and supports the efforts of the Department to conform the MFJ to the realities of the marketplace.

Perhaps the most profound change in the telecommunications industry since the announcement of the settlement that resulted in the MFJ is the existence of the seven Regional Holding Companies

(RHCs) as independent, publicly-held companies. The integrated Bell System no longer exists. The seven RHCs do not act as a single entity; on the contrary, they compete vigorously with each other. The divestiture thus produced an industry structure that is itself an effective deterrent against even subtle attempts to abuse any advantages that might arise from ownership of local exchange telecommunications facilities.

As the U.S. District Court for the District of Columbia has recognized in administering the MFJ, the appropriate standard for removing the line of business restrictions is the test enunciated in Section VIII(C) of the MFJ. This standard was created by the Court specifically for this case and was incorporated into the MFJ as the test for determining what businesses the BOCs may enter. The standard provides that a line of business restriction should be removed upon a showing "that there is no substantial possibility that (the BOC) could use its monopoly power to impede competition in the market it seeks to enter." Although the District Court must adhere to this antitrust standard, SBC believes that these issues raise broad public policy questions beyond antitrust law that Congress must consider before taking any action.

Congress must recognize that the restrictions imposed by the MFJ are not without cost. They have an adverse impact on America's competitiveness in the international telecommunications market, with negative implications for the balance of trade and domestic employment. They withhold advanced technology services from the average American consumer, threatening to divide our society into the "information rich" and the "information poor." And, in some instances, the restrictions may actually dampen the fire they were intended to fan; competition.

At a time when the balance of trade is the subject of great public concern, our government seems to be sending mixed signals to the nation and the rest of the world. One branch of the government feels justified in retaliating against a trading partner for closing its markets to us, while seven of America's largest telecommunications firms are forbidden by another branch from even trying to enter those markets with domestically-produced goods. Much has been written about the exportation of American jobs, yet the MFJ restrictions prevent the BOCs from entering markets that are currently dominated by foreign firms.

Information services are supposed to be one of the cornerstones of the Information Age. These advanced services, many of them invented and developed in America, are available here, but only to corporations or other wealthy users who can afford a private network or expensive terminal equipment that contains the necessary intelligence. In other countries this intelligence has also been placed in the public switched network, where it is available to the individual consumer. That cannot be done here because of the MFJ restrictions, so the promise of the Information Age has not yet been kept for the average American.

Even interexchange service, the arena in which the antitrust battles that spawned the MFJ were originally fought, has been negatively impacted by its restrictions. What was expected to be a highly competitive market is really an oligopoly, dominated by AT&T with one or two much smaller competitors following its lead. The BOCs are kept from the field, despite the significant competition that they could offer.

The MFJ was intended to be a transitional device, not a permanent set of rules. The time has come to recognize the dramatic changes in the telecommunications industry and get on with fostering the development of this industry.

SBC supports the Department's recommendation that the MFJ prohibition on BOC provision of information services be removed. As the Department pointed out, the information services restriction was not based on any underlying allegation in the AT&T antitrust trial; rather, it was based on an assumed analogy to interexchange services. The FCC has had long and comprehensive experience in regulation of the manner in which a common carrier may provide enhanced services/information services. Thus, the safeguards that the FCC has developed are sufficient to ensure that BOC entry into information services would not impede competition in that market.

Under the FCC's Computer II rules, the BOCs could enter the enhanced services/information services market only through structurally separate affiliates. Recognizing that the technology to support the provision of enhanced services/information services has developed significantly, the FCC initiated its Computer III proceeding. In doing so, it observed that certain problems attributable to the MFJ and FCC restrictions had arisen. First, many information services and enhanced services are not easily distinguishable from basic exchange telecommunications services. In addition, it became increasingly obvious that the restrictions on the BOCs had the unintended effect of depriving some customers of the benefits of information or enhanced services. Many such services are most efficiently provided through the local switch. Large customers may receive those services through connection with a PBX switching system, but smaller customers do not have that service option. The MFJ/FCC restrictions thus have prevented the general public from enjoying a full range of telecommunications services, including information/enhanced services, because non-BOC service providers have directed their attention to large businesses and institutional customers.

In Computer III, the FCC has decided that these problems justify relaxing or removing the Computer II separation rules, but only as the BOCs comply with the extremely strict non-structural safeguards that the FCC has prescribed. These safeguards (cost allocation rules, Open Network Architective/Comparably Efficient Interconnection plans, network information disclosure requirements, and Customer Proprietary Network Information disclosure procedures) satisfy the test established by the Court in the MFJ by ensuring that the BOCs cannot cross-subsidize or discriminate to impede competition in the information services market.

SBC agrees with the Department's recommendation that the District Court remove the MFJ prohibitions on BOC manufacture and provision of telecommunications equipment and on BOC manufacture of Customer Premises Equipment (CPE). Regulatory and economic changes since the MFJ was implemented have obviated the need for this restriction.

First, the telecommunications equipment manufacturing market is already competitive and dominated by very large companies, such as AT&T, Northern Telecom, IBM/Rolm, Siemens, Ericsson and NEC. A new BOC entrant begins with zero market share against very strong competition.

Second, as a buyer each BOC represents a small portion of the national market and an even smaller portion of the world market. Consequently, no BOC's procurement decisions have a large enough impact to threaten competition, nor does the individual BOC provide a sufficiently large "captive" market to be the sole support for any significant manufacturing enterprise.

Third, the relatively small market that each BOC represents also argues against a BOC designing a "proprietary" network to discriminate against the equipment and CPE of its competitors. Using its own standards to balkanize its network in this fashion, besides the obvious and easily detectable impropriety, would result in the foreclosure of the rest of the nation and the world as a market for the BOC's products. It is in the BOC's own self-interest to conform to the standards set by the national and international bodies charged with that responsibility.

Fourth, the cost allocation rules set by the FCC will ensure that the BOCs do not cross-subsidize their manufacturing enterprises with the revenues from their regulated activities.

Under these conditions, BOC entry into the telecommunications equipment and CPE manufacturing businesses is not a threat to competition. On the contrary, BOC entry will increase competition and could enhance the U.S. trade position in these critical world markets.

With respect to interexchange services, SBC believes that the regional and operating telephone companies now subject to the MFJ should not be restricted in the provision of interLATA services, whether within or outside their respective regions. Specifically, SBC supports removal of the restriction prohibiting it from providing interexchange private telecommunications networks on a facility or resale basis within or outside its region. These customers invariably are sophisticated in their selection and use of telecommunications facilities and services and are capable of determining and obtaining their telecommunications requirements independently of the public switched network. SBC could not manipulate its ownership of access facilities to the detriment of SBC's competitors or potential customers for this type of service.

SBC supports the Department's recommendation that the interexchange services prohibition should be removed to permit the BOCs to provide, without restriction, interexchange mobile radio services in all geographic areas. These markets are currently competitive, and the BOCs are participating in the intraexchange portion of the markets without damage to competition. Allowing the BOCs to engage in interexchange competition would not increase the risks to competition in mobile radio services markets.

SBC also seeks removal of the restriction prohibiting it from providing any other interexchange service, within or outside its region, subject, however, to its provision of such services through a subsidiary which is structurally separate from SBC's operating telephone subsidiary and subject to all applicable rules and regulations of the FCC. Such structural separation would prevent SBC's ownership of any monopoly facilities from impeding competition in the interexchange market.

Finally, SBC supports the Department's recommendation that the Court remove the MFJ restriction that bars BOC entry into nontelecommunications lines of business. A BOC has no ability to use its local exchange telecommunications facilities to impede competition in nontelecommunications businesses. In addition, the FCC's cost allocation rules protect against cross-subsidization of competitive services by regulated services.

SBC appreciates the opportunity to present its views to the Subcommittee and is willing to provide it with additional information if necessary.

CBEMA

ORGANIZATION: Computer and Business Equipment Manufacturers Association (CBEMA)

ADDRESS: 311 First Street NW, Suite 500
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COMMITTEE: Senate Judiciary Subcommittee on Antitrust

SUBJECT: Modifications to AT&T Decree

DATE: April 30, 1987

SUMMARY: CBEMA favors fair and open competition in the marketplace. However, CBEMA opposes elimination of the restrictions on the BOCs' activities as premature. Before these restrictions are eliminated, the BOCs should implement, test, and demonstrate a uniform nationwide Open Network Architecture standard, a cost-allocation and accounting system to preclude cross-subsidization between regulated and unregulated services, safeguards to prevent the unregulated arms of the BOCs from having access to information not available to telecommunications competitors, and measures to foreclose the BOCs from discriminating against other users of the local network. Additionally, before the restraints are removed, states should remove legal impediments to exchange access competition, and effective competition must, in fact, exist.

CBEMA STATEMENT OF POSITION

CBEMA holds the position that lifting the line-of-business restrictions on the BOCs at the current time would be premature. CBEMA's members fully and unequivocally support the ideal that competition in the marketplace is the cornerstone of our economy, and CBEMA's position, as hereafter explained, reflects a desire not to limit competition in the telecommunications, information services or other markets, but rather to encourage fair and open competition among all potential entrants. If the Bell Operating Companies are to enter new businesses, the Court, which first accepted the line-of-business restrictions as an integral part of the MFJ, must continue to insist that the environment for competition in such markets be fair. In particular, it must ensure that no competitor will enjoy the opportunity to exert an anti-competitive force in one market due to its position as a natural monopolist in another market. When -- and only when -- the Court is satisfied that the BOCs will no longer be able to exert the anti-competitive forces of their bottleneck monopoly will it be appropriate for the BOCs to compete in these markets.

Thus, CBEMA would not oppose BOC competition in the Information Services marketplace when: (1) the FCC's Open Network Architecture 6/ program has been effectively implemented and tested on a uniform, standardized, nationwide basis, and provides for equal and fair access to the BOCs' local exchange bottleneck facilities by any interested competitor; (2) adequate cost accounting and other regulatory mechanisms are tested and in place on a national basis; and (3) the states have removed legal impediments to exchange access competition and such competition, in fact, exists as an alternative to BOC access to the local exchange customers.

Similarly, CBEMA will not oppose BOC entry into the telecommunications and CPE manufacturing markets when (1) adequate cost accounting safeguards are in place; (2) a procurement policy has been imposed on the BOCs to assure that they deal fairly with their competitors in reaching for a captive marketplace within their region; and (3) prohibitions are in place to prevent the BOCs' unfair use of network design information, on the one hand, or customer proprietary information on the other.

Absent such safeguards, and until the safeguards are implemented, tested and demonstrated, the BOCs' ability to misuse their monopoly local exchange services position in such markets is substantial. CBEMA is convinced that circumstances supporting competition do not yet exist. We therefore consider the DOJ proposals to be premature and urge Congress to defer any legislative action to relax the MFJ.

6/ Computer III at {{ 201-222.

SUMMARY OF STATEMENT
OF
PACIFIC TELESIS GROUP

Before the Senate Subcommittee on Antitrust,Monopolies and Business Rights
April 30, 1987

Pacific Telesis hopes that this subcommittee and the whole of Congress will urge the Court to remove unconditionally the restrictions imposed on the Bell Operating Companies (BOCs) by the Modification of Final Judgement (MFJ).

Restrictions were placed on the BOCs based on hypothetical anticompetitive behavior and on agreements between the parties to the antitrust case, AT&T and the U.S. Department of Justice (DOJ). At that time, the parties and the Court could only guess at what the post-divestiture telecommunications industry would look like, and the Court cautiously placed broad restrictions on the BOCs while recognizing the need to reconsider the restrictions when facts were available.

The Huber Report submitted by the DOJ in support of its proposals to waive the MFJ restrictions is a comprehensive, contemporary body of work. Since most, if not all, of the support for creation of the restrictions was based on events and technologies that were dated at the time the decree was entered, the Huber Report is the Government's first relevant and full analysis of the restrictions. The report analyzes the _current_ state of technology and competition and provides firm support for the DOJ's conclusion that most of the restrictions are no longer warranted.

The Court has set forth _three tests_ for determining whether restrictions should be removed under the decree:

1. Will the BOCs "actually have the incentive and opportunity to act anticompetitively"?

2. Will participation by the BOCs contribute to the creation of competition?

3. What is the "effect of the restrictions upon other important public policies"?

Test No. 1 - Avoiding Anticompetitive Behavior

The absence of monopoly power in the local exchange is certainly a sufficient predicate for the removal of the line of business restrictions. It is not, however, a prerequisite. The Court has consistently emphasized that the mere existence of monopoly power is _not_ a sufficient justification for the line of business restrictions. Section VIII(C) of the MFJ clearly requires the removal of the II(D) restrictions when the petitioning BOC can show that there is no substantial possibility that "it could _use its monopoly power_" to impede competition in the market it seeks to enter (emphasis added). Thus, VIII(C) assumes the existence of monopoly power, and sets out the circumstances under which the restrictions "shall" be removed despite that monopoly power (552 F.Supp. at 194-195).

The single circumstance that the BOCs continue to serve as the sole provider of local exchange telephone service for small users is not a sufficient basis for restricting the BOCs where other factors such as equal access, effective regulatory controls and market forces stand squarely in the way of transfering local exchange monopoly power to the information services, manufacturing and interexchange telecommunications markets.

In 1982, information services competitors asked the Court for a headstart in developing their market shares before the BOCs entered into these markets. The Court responded by including the information services restrictions in the decree. Now, five years later, these competitors, who include some of the largest corporations in the world, have had their headstart, and yet they ask for more.

Similarly, if allowed to compete in the manufacturing and interexchange services markets, the BOCs will start from far behind, with no experience and no market share in the markets, and they will face giant competitors, including AT&T and foreign corporations. The question should not be how to protect this group of companies from new competitors but how to enhance competition in markets that are so dominated by a single provider, namely AT&T. Allowing entry of the BOCs could help achieve the effective competition envisioned by the antitrust laws.

Test No. 2 - Creating Competition

Lifting the decree prohibitions will result in seven potential new entrants in the markets. Their ability to enter will in itself provide competitive pressure, resulting in improved services and products and lower prices for consumers not only of services and products provided by the BOCs but also of competing services and products provided by others.

The information services restriction prevents BOCs from providing many advanced services which could be offered more efficiently through integration with the public switched telecommunications network. Absent such integration, the cost of such services may continue to make them unavailable to residential and small business consumers. Moreover, while large businesses may be able to build private networks or purchase necessary customer premises equipment or computers to provide such services, these businesses may needlessly be incurring upfront capital outlays and risks of equipment obsolescense.

The entry of BOCs into manufacturing will stimulate competition. Those who oppose BOC entry seek to protect their own competitive positions--to protect their market shares, not promote competition.

The interexchange services market is rapidly consolidating around a small group of large facilities-based carriers. This small group, which appears to be raising and lowering rates in tandem, has proved capable of taking care of itself. Far from having an advantage, the BOCs would face formidable odds if they attempt to enter the domestic interexchange market in head-to-head competition with AT&T, MCI, Sprint and others who have had the benefits of the presubscription balloting process. Permitting Pacific Telesis and the other Regions to compete in the interexchange market will contribute to lasting, healthy competition.

Test No. 3 - Effects On Other Public Interests

The continued MFJ prohibition on Pacific Telesis' provision of information services runs counter to the First Amendment, harming not only the BOCs but the public generally.

Another major concern is the effect of the restrictions on the ability of the BOCs to keep up with technological developments. Dr. Huber's prediction of things to come if the BOCs are not permitted to participate, and to help their customers participate, in the technological revolution that is already well underway, provides a sobering backdrop to any analysis of the future role of the line of business restrictions:

> "And of course the RBOCs will remain system integrators for the poor, the tired, and the hungry. But this undoubtedly important responsibility is one that few for-profit companies will choose as their only one. It remains quite possible that the RBOCs will become the U.S. Post Office of electronic telecommunications, absolutely essential to many, with steady or even growing traffic, shored up by an obsolete statutory monopoly, but moribund nontheless." (Huber, p. 1.23)

Conclusion

Congress should urge the Court to remove the restrictions unconditionally. Once the decree restrictions are gone, Congress will once again be in the position to set national telecommunications policy to be carried out by the FCC, and States will be able to implement their telecommunications policies. Benefits of this rational and industry-wide regulatory system will accrue to consumers and our nation.

STATEMENT OF
PACIFIC TELESIS GROUP

Before the
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

of the
COMMITTEE ON THE JUDICIARY

of the
UNITED STATES SENATE

April 30, 1987

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INTRODUCTION

Pacific Telesis Group is pleased that Congress is reviewing the impacts on ratepayers and competition which would result from implementation by the decree Court of the Department of Justice's (DOJ's) recommendations.[1] The DOJ recommends removal of most of the line of business restrictions which were placed on the Bell operating companies (BOCs) by the decree (the Modification of Final Judgment or "MFJ") which divested the BOCs from American Telephone and Telegraph Company (AT&T). The decree currently prohibits the BOCs from providing information services and interexchange services, from manufacturing and providing telecommunications equipment, from manufacturing customer premises equipment, and from entering into non-telecommunications businesses, without a Court granted waiver. Based on an extensive analysis of the current state of the telecommunications industry and the effects of the restrictions, the DOJ recommends removing the decree restrictions on all of these businesses, except in-Region interexchange services.

The conditions under which the BOCs should be allowed to enter these various businesses involve a variety of broad public policy issues. The public interests underlying these BOC activities include the development of technology and new services, maintenance of universal telephone service at reasonable rates, and effects on United States trade and competitiveness. By virtue of its control over the decree restrictions, the Court has been making decisions vital to the outcome of these public interests. While this may have been justified for a time after divestiture, it would be improper for the Court to continue this role.

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[1] "Report and Recommendations of the United States concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment" ("Department of Justice (DOJ) Report"), February 2, 1987. Included with the DOJ Report is: "The Geodesic Network, 1987 Report on Competition in the Telephone Industry", Peter W. Huber, independent consultant to the DOJ (The "Huber Report") January 1987.

The purview of the Court is limited to relatively narrow antitrust criteria. Such a narrow perspective is inappropriate for dealing with broad public concerns. For instance, as we discuss below with regard to cross-subsidies, pricing services below incremental costs involves predatory pricing which is of concern to the Court, but shifting of costs between services involves universal service which is of concern to regulators.

The Federal Communications Commission (FCC) is the agency historically charged by Congress with responsibility for national telecommunications policy. It has the requisite subject matter expertise and a broad public interest mandate. In its rulemaking proceedings, it requests comments from all interested parties, including the Departments of Justice, Commerce and Defense. State commissions have also attained years of experience in dealing with telecommunications issues, and they are located close to the consumers and companies involved in the issues.

Since divestiture, the FCC and state regulators have developed numerous accounting, auditing, non-discriminatory interconnection and other safeguards for ratepayers and competition as BOCs are allowed to move into new businesses. Removal of the decree restrictions will not "free the BOCs" but will free regulators, so that they can carry out the mandates of Congress and state legislatures.

The presence of these public interest and regulatory issues makes Congressional review of the DOJ's recommendations not only appropriate but essential. Pacific Telesis hopes that this subcommittee and the whole of Congress will urge the Court to remove unconditionally the restrictions. In that way, the Congress and the FCC will be free to carry out telecommunications policy for all participants in the industry, without the narrow antitrust restraints imposed on the BOCs.

This statement is intended to address the antitrust concerns relative to the MFJ line of business restrictions, as a current matter before the divestiture Court, and the primary subject for review under the jurisdiction of this subcommittee.

THE MFJ RESTRICTIONS WERE PLACED ON BOCS BASED ON HYPOTHESIS, NOT FACT

A brief review of the creation of the decree which broke up the former Bell System reveals that restrictions were placed on the BOCs based on hypothetical anticompetitive behavior and on agreements between the parties to the antitrust case, AT&T and the DOJ. At the time, the parties and the Court could only guess at what the post-divestiture telecommunications industry would look like, and the Court cautiously placed broad restrictions on the BOCs while recognizing the need to reconsider the restrictions when facts were available.

At the trial which resulted in the divestiture, the DOJ claimed that the "potentially" competitive markets impeded by AT&T were intercity services, customer premises equipment and telecommunications equipment. Information services, international telecommunications and non-telecommunications businesses were not part of the Government's case. Thus, prohibitions against BOC participation in these latter businesses, which were agreed to by AT&T and DOJ, were not based on evidence or related to the DOJ's allegations of anticompetitive behavior. (524 F Supp. 1246) In addition, although the DOJ alleged various acts of discrimination by AT&T, DOJ found no empirical evidence of cross-subsidy.[2] Moreover, most, if not all, of the DOJ's evidence presented at trial involved the technology, events, and industry structure of the 1960s and 1970s.[3]

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[2] DOJ Discussion Paper EAG 86-5, 1986, Dr. Timothy J. Brennan at pp. 36-38.

AT&T went along with the DOJ's broad line of business limitations on the entities to be divested; not because they were "a good thing", but simply because the DOJ included them in the overall "bargain".[4] It was apparently the view of AT&T that the line of business restrictions were unnecessary,[5] and it advised the FCC sitting en banc that AT&T "do[es] not want restrictions on the BOCs".[6] That colloquy included the following:

> "Commissioner Fogarty: '. . . But by the same token, I was pleased to hear that you didn't volunteer to restrict the divested BOCs from participating in competitive enterprises because that seems to me to be an unfair restriction on these new independent telephone companies. And so I take it you wouldn't object if this Commission should suggest to the Court that that sort of restriction should be removed from the BOCs once divested.'
>
> "Mr. Trienens: 'Not at all. Mr. Brown was asked that very question before an N-A-R-U-C group and he said that it wasn't our idea and the question was--'Well, if Justice agreed to eliminate the restrictions would you agree, and the answer was "Of Course"."

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[3] See, Plantiff's Third Statement Of Contentions and proof (discussing allegations covering period from 1945 - 1976), in U.S. vs. Western Electric and AT&T, Civil Action 82-0192.

[4] See, 552 F.Supp. at 186 n. 227; Transcript, June 29, 1982, p. 25211 ("The Court: I'm not sure I follow you entirely. Are you saying that you agree to the restrictions on the BOCs because you think they are a good thing, or are you saying you agree to them because Justice required it as a part of the bargain? AT&T's attorney, Mr. Trienens: The fact is it's the latter.")

[5] See, Transcript, June 29, 1982, p. 25210. AT&T's attorney, Mr. Trienens: "I'm against restrictions. I'll be happy if nobody is restricted on anything. After this divestiture occurs, let them do what they want.")

[6] Brief of the FCC as Amicus On Question No. 1 (June 14, 1982) p. 8-9; quoting from FCC hearing on proposed modification, March 24, 1982.

The Court expressed concern about the proposed line-of-business restrictions and fundamentally differed with the DOJ's position that the BOCs should be barred from all but the local exchange business. The Court noted that the DOJ had equated the individual, soon-to-be divested, BOCs with an integrated AT&T, which then controlled 80 percent of the nation's local exchange service and dominated the interexchange market (552 F.Supp. at 187). The Court emphasized that, in contrast to AT&T, the divested BOCs would have a monopoly only in local communications and, "if permitted to enter competitive markets, [will] be faced with the most potent conceivable competitor: AT&T itself" (id.). The existence of a local exchange monopoly was not a sufficient reason, in and of itself, to bar them from entering new markets (id. at p. 187).

The Court recognized the vital differences in the market power available to the divested BOCs and that which allegedly had been wielded by AT&T. The Court, therefore, did not accept the agreement between the DOJ and AT&T as sufficient and ameliorated the harshness of the overly broad restrictions by requiring the parties to add Section VIII(C) to the decree. That section permits removal of the Section II(D) line of business restrictions "upon a showing that there is no substantial possibility that an Operating Company could use its monopoly power to impede competition in the relevant market (footnote omitted)" (552 F.Supp. at 195; MFJ, Section VIII(C)).

The DOJ itself recognized the unusual breadth of the line-of-business restrictions and that because of their inherent anticompetitive effect they warranted "the most careful scrutiny". Moreover, the DOJ and the Court recognized and took account of the fact that the industry and technology that had formed the evidence of record during the trial was already dated. Accordingly, the DOJ recommended and the Court ordered a report every three years following divestiture on whether there was any need for the restrictions.

NOW THAT FACTS ARE AVAILABLE, IT IS APPARENT THAT THE RESTRICTIONS ARE NOT WARRANTED

Every restriction, of course, develops its own constituency of those who are advantaged by its perpetuation. The task of the Court and of policymakers is to distill out the ingredients of consumer welfare when the mass of advocates may be seeking their own individual competitive welfare.[7]

There are, however, some intervenors--and one party--who have no economic axe to grind in the Court proceeding. Their views, we submit, are entitled to special consideration. Based on its extensive analysis of the current condition of the telecommunications industry, the DOJ now strongly urges that the line of business restrictions be lifted (except with respect to interexchange services). The DOJ has been joined, in whole or in large part, by the Federal Communications Commission (FCC), the National Telecommunications and Information Administration (NTIA) and the National Association of Regulatory Utility Commissioners (NARUC).

In addition, although a few state Commissions oppose relaxation of the restrictions, the vast majority of intervening states support removal of some or all of the restrictions. Those in support include the state regulatory agencies in California, Arizona, Florida, Illinois, Michigan, Minnesota, Missouri, New York, Pennsylvania, Vermont, Virginia, West Virginia and Wisconsin.

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[7] Congress designed the Sherman Act as a "consumer welfare prescription" (NCAA v. Board of Regents, 468 U.S. 85, 107 (1984), quoting Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979)). The vast majority of the March 13, 1987 Comments to the Court on the Department's recommendations reflect competitor views of their own welfare rather than the welfare of the consumer, which was the keystone of the Department's recommendations.

The Huber Report submitted by the DOJ in support of its proposals to waive the MFJ restrictions is a comprehensive, contemporary body of work. Since most, if not all, of the support for creation of the restrictions was based on events and technologies that were dated at the time the decree was entered, the Huber Report is the Government's first relevant and full analysis of the restrictions. The report analyzes the current state of technology and competition and provides firm support for the DOJ's conclusion that most of the restrictions are no longer warranted.

Findings Which Are Not Required For Removal Of Restrictions

Many commentors would have the Court and policymakers focus on the historical record in the AT&T litigation, and on stipulations entered into by AT&T and DOJ during--and even before--trial of the Government's case. Their argument is that what they suggest has happened in the past could happen again, and vigilance in the form of perpetuation of the restrictions is required (March 13, 1987, Comments to the Court: MCI at 11-12, 18-26, 31; AT&T at 15-19, 25-27; Ad Hoc at 19).

This sort of backward orientation is neither useful nor permissible under the decree in considering whether to remove the restrictions. The old trial record is outdated, and the trial involved a party, the Bell System AT&T, which no longer exists. As the Court has said: "It is the potential for present or future anticompetitive conduct, not prior conduct, that is relevant when the court reviews a waiver request" (1986-1 Trade Cases at p. 62,058 n. 13). And the Court has squarely established that the mere "theoretical ability to engage in anticompetitive conduct is not enough" (592 F.Supp. at 852); there must be a "realistic possibility of abuse of monopoly power" (552 F.Supp. at 195, n. 267).[8]

Several commentors have also argued that the decree's restrictions may not be removed "unless and until the BOCs' local exchanges have ceased to be monopolies and 'bottlenecks'".[9] This is simply wrong.

The absence of monopoly power in the local exchange is certainly a sufficient predicate for the removal of the line of business restrictions. It is not, however, a prerequisite. The very language of VIII(C) is inconsistent with any such limitation: VIII(C) clearly requires the removal of the II(D) restrictions when the petitioning BOC can show that there is no substantial possibility that "it could use its monopoly power" to impede competition in the market it seeks to enter (emphasis added). Thus, VIII(C) assumes the existence of monopoly power, and sets out the circumstances under which the restrictions "shall" be removed despite that monopoly power (552 F.Supp. at 194-195).

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[8] In essence, the test defined by the Court in VIII(C) of the MFJ is similar to the standard under section 7 of the Clayton Act (15 U.S.C. Section 18). The Court has noted that the level of the prohibited activity is not that of an antitrust violation, but rather whether there is a "substantial possibility that the operating companies could impede competition (footnote omitted)" (592 F.Supp. 869). The section 7 standard is whether there is a reasonable probability that condemned restraints are likely to result (United States v. DuPont & Co., 353 U.S. 586, 607 (1956)). "The 'mere possibility' of the prohibited restraint is not enough. (Citation omitted.) Probability of the proscribed evil is required . . ." (Federal Trade Commission v. Consolidated Foods Corporation, 380 U.S. 592, 598 (1964); emphasis added).

[9] See for example the following March 13, 1987, Comments to the Court: AT&T at 9, 11, 30-31, 37; MCI at 6-7, 18-19; Ad Hoc Telecommunication Users Committee at 27; National Telecommunication Network at 12-13; Competitive Telecommunications Assoc. at 3-4; Wang Information Services Corp at 6, n. 4; Tandy Corporation at 6-8; General Electric Communications and Services at 18-20; Cybertel Corporation at 25-26; ACI at 5-6.

The Court has consistently emphasized that the mere existence of monopoly power is not a sufficient justification for the line of business restrictions:

> "That single circumstance - important though it may be - is not a sufficient basis upon which to restrict competition generally in the name of the antitrust laws. If this were the case, all monopolies might have to be barred from competitive industries and even the Department of Justice acknowledges that drastic remedy is not required." (552 F.Supp. at 187).

Moreover, the Court has already granted over 100 waivers pursuant to VIII(C) without examining whether the BOCs have local exchange "monopolies". Most of those waivers have been granted without any suggestion that the facts are "new" and in most cases (for example, the pre-1984 waivers) there plainly had been no change in circumstances.

Changed Circumstances

Many of those who have commented to the Court have insisted that removing restrictions under Section VIII(C) of the decree requires a finding of "changed circumstances". We disagree and, as noted in the previous paragraph, the Court has not required such a finding. In any event, there have been substantial pertinent changes in all aspects of the telecommunications business since the entry of the decree. Those changes are described in detail in the DOJ's Report and briefly in this statement. It is on the basis of the current status of competition and regulation in the industry that the restrictions should be removed.

For instance, the Court agreed to the restriction on information services based on speculative concerns that the information services business was an "infant industry" and that the BOCs' local exchange services constituted a "bottleneck" which BOCs could use to discriminate against information services competitors. Whatever merit such speculation may have had before divestiture, circumstances have changed considerably since that time.

The information services industry has become very competitive as large corporations such as AT&T and IBM, which definitely are not "infants", have rapidly expanded their reach into the information services industry by forming alliances with other domestic and foreign corporations. Further, since divestiture a variety of means of bypassing the local exchanges, such as private microwave systems and mobile service exchanges, have been developed, undermining the "bottleneck" justification for the restriction. Any attempt by a BOC to discriminate in the offering of its local exchange services would encourage increased use of such bypass capabilities by information services competitors.

Circumstances have also changed since divestiture with regard to the manufacturing and interexchange services line of business restrictions. Prior to divestiture, AT&T produced the vast majority of telecommunications equipment used by U. S. telephone companies and provided almost all domestic long distance service. As a result of divestiture and FCC actions, the U. S. market has become wide open to foreign and domestic manufacturers. At the same time, with the development of equal access, interexchange competition between large carriers has increased, and any potential attempts at discrimination in offering local exchange services have been made futile. If the BOCs entered the manufacturing and interexchange businesses, they would be new to the businesses and would face this stiff competition, including that from AT&T itself.

These competitive forces which have developed since divestiture would work to prevent anticompetitive behavior by the BOCs. Another major change since divestiture has been the development by the FCC and state regulators of accounting and other safeguards for ratepayers and competition to be applied as BOCs enter new businesses. The independent but similarly situated BOCs give regulators the ability to make useful comparisons in developing safeguards. The BOCs, along with GTE, provide regulators with a set of benchmarks that will allow them to determine whether one company or another is engaging in anticompetitive activities. Such comparisons were not possible in the unified Bell System prior to divestiture.

Whatever speculative justification there might have been for the Court to retain jurisdiction over the line-of-business restrictions for a time after divestiture is gone. The development of competitive forces, together with experience with competitive markets which has been acquired by regulators during the ensuing years, mandate transferring that jurisdiction back to regulators who are responsible to the guidelines of Congress on telecommunications policy.

Determining Whether to Remove Restrictions

The Court has set forth three questions to be answered in determining whether restrictions should be removed under Section VIII(C) of the decree (552 F.Supp. at 195):

1. Will the BOCs "actually have the incentive and opportunity to act anticompetitively"?
2. Since the restrictions themselves are "directly anticompetitive because they prevent a potential competitor from entering the market", will participation by the BOCs contribute to the creation of competition?
3. What is the "effect of the restrictions upon other important public policies"?

The following sections of this statement respond to these questions.

TEST NUMBER ONE

THE BOCs DO NOT HAVE THE INCENTIVE AND OPPORTUNITY TO ACT ANTICOMPETITIVELY

The first question to be answered in determining whether restrictions should be removed under Section VIII(C) of the decree is: "Will the BOCs actually have the incentive and opportunity to act anticompetitively?"

The Economic Reality Is That The BOCs Will Not Use Their Local Exchange Businesses To Cross-Subsidize Other Businesses.

There is much confusion regarding the type of pricing which is of antitrust concern. Antitrust courts have consistently held that prices for competitive services which are high enough to cover the costs caused solely by such services (marginal, direct or incremental costs) are not predatory. Shifting of joint or common costs between monopoly and competitive services has not been considered anticompetitive from an antitrust point of view.[10] The issue is treated differently by the regulatory authorities who have evolved elaborate accounting and auditing safeguards to ensure that prohibited price shifting will not occur.

The amount of joint or common costs which should be covered by each type of service has been and should be considered a regulatory matter. Regulators often set prices which shift such costs to reflect social policies, such as maintaining universal telephone service.[11] As the courts have pointed out, so long as new competitive services pay any portion of common costs, ratepayers of regulated services benefit from a carrier's provision of such new services.(Id.)[12]

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[10] MCI v. AT&T, 708 F2d 1081, 1123 (7th Cir. 1983); Northeastern Tel. Co. v. AT&T, 651 F2d 76, 90 (2d Cir., 1981); and Southern Pacific Communications v. AT&T, 556 F. Supp. 825, 927 (D.D.C. 1983), affirmed 740 F.2d 980 (D.C. Cir. 1984).

In order for a BOC to be guilty of cross-subsidy in antitrust terms, the BOC would have to be pricing its competitive services below incremental costs and recouping the losses with inflated profits from its regulated communications services. Such activity would be irrational. Even if it is assumed for the sake of argument that a BOC could mislead regulators and increase its profits for regulated services, it would have no incentive to waste those profits by using them to offset losses in the competitive market, unless it could drive the competitors in that market out of business and recoup its losses.[13] For a BOC to expect to later raise prices and recover lost profits in the information services industry, for example, it would have to expect to drive out its information services competitors.

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[11] If BOCs were allowed to offer information services in the public network, regulators could allocate to information services some costs of the embedded network that are not incrementally caused by such services. (The FCC established rules to do so in "Part X", docket 86-111.) This could spread the fixed costs (costs which are joint or common, including non-traffic-sensitive costs) of the network among more services, providing an important consumer benefit, particularly as traditional sources of basic rate support decline.

[12] For example, the California Public Utilities Commission sets prices for basic telephone service well below their costs by shifting some of their costs to toll and other services which are priced well above their costs.

Whatever plausibility this theory might have had with reference to pre-divestiture AT&T in 1981, it is not plausible today. For a BOC to rationally attempt such a scheme, the BOC would have to expect to drive out AT&T, IBM, Dun and Bradstreet, and many other giant competitors, including many foreign ones. And it would have to expect to fool regulators, who since 1981 have become very experienced in regulating the relationships between regulated and competitive services, until it had driven the competitors out of business. These would be entirely unrealistic expectations.

Market Forces Would Prevent BOCs From Acting Anticompetitively

1. Information Services

It is not in the BOCs' self-interest to discriminate against information services competitors. Any discrimination would only serve to encourage the other information service providers to provide services through the transmission facilities of others or through other media (DOJ Report at 128-29). Since the majority of BOC revenues come from use of the network, making interface with our network more difficult would place our most important source of revenue at risk and would be contrary to our own self interest.

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[13] The Supreme Court noted in Matsushita v. Zenith 475 U.S. ____, 89 L. Ed. 2d 538 (1986) that a rational business will not predatorily price unless it expects to recover lost profits later, after it has driven its competitors from the market.

In any event, any attempt to discriminate would be futile. There are "literally thousands" of participants in information services including "the nation's leading corporate giants, as well as . . . many smaller concerns" (552 F.Supp. at 179) (Huber, Table IS.3 at 7.3-7.7). "[P]owerful firms with established bases in product areas that provide them with economies of scope and scale are entering information services markets" (DOJ Report at 112). For example, major suppliers of online information services in North America include: Mead Corporation, TRW, Dun & Bradstreet, Lockheed, Dow Jones, West Publishing, and H&R Block (Huber at Tables CDB.2, CDB.8). In some markets, providers may include equipment manufacturers as well. For example, providers of voice storage and retrieval are diverse and include major hardware manufacturers such as Wang and AT&T as well as service providers such as VMX and GTE (Huber at 10.2-10.8). As the Huber Report concludes:

> "Even putting aside foreign competitors, the U.S. firms already jockeying for position in the global information markets are not generally numbered among the small and the timid of the corporate world. A breakdown of the major U.S. videotext players, for example, reads very much like a truncated list of the Fortune 500" (Huber at 6.50-6.51). (Table IS.23 omitted.)

In addition, major companies have formed information service joint ventures. These include Covidea, a videotext joint venture owned by AT&T, Chemical Bank, Bank of America and Time, Inc.; and Trintex, owned by IBM and Sears. These information service providers clearly have the economic resources to "combat any attempt at discrimination" (552 F.Supp. at 179), and any attempt at discrimination would only enhance the possibility of others providing products or services not dependent on our facilities (552 F.Supp. at 179-80).

Even if BOCs could discriminate, the Huber Report demonstrates that any ability to impede an information service provider's access to customers is limited by the numerous alternatives to the local exchange. These include customer premises equipment or microcomputers, national-level gateways (e.g., AT&T's 900 service), mobile service exchanges, alternative electronic distribution systems (e.g., private microwave and fiber optic systems), and non-electronic distribution systems (e.g., print media) (Huber at 6.11-6.14, 6.18).[14] For instance, should the BOCs be allowed to provide information services, consumers considering our voice storage and retrieval service might choose to use an answering machine, a telephone answering service, or a service bureau instead. Consumers could do their own data processing with a microcomputer rather than through a remote computing service which uses the local exchange. Evolving technologies offer the potential for even more bypass of the network for the delivery of information. Thus, "the market itself provides some assurance that the trend toward equal access for [information service providers] will continue whatever form regulation may take" (Huber at 6.25).

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[14] For example, there are private switches now in place that substitute for 30 million lines that would otherwise be switched by telephone central offices. (Huber Report at 2.6.) The capacity of private microwave systems has grown from 270,000 voice grade circuits in 1982 to 3,400,000 in 1986, an increase of more than 1100 percent, and the growth of private fiber optic systems is even more dramatic. (Huber Report, Tables L.15 and L.16) These systems can be substituted for telephone company access lines, tie lines and other exchange services.

The current and rapidly expanding ability to bypass the BOCs' networks is illustrated by the activities and statements of AT&T. AT&T is actively marketing a short-haul microwave radio designed to bypass BOC services, "a compact, economical transmission system... that sends and receives information across the street or across town."[15] AT&T tells its customers that this system is so economical that it "can pay for itself in less than a year in most cases."[16]

AT&T has also restructured its service offerings--particularly those services which are used by private network customers--giving its high volume customers the opportunity and incentive to bypass the BOCs.[17] Furthermore, AT&T has reportedly announced to its high volume customers that it can assist them to build their own facilities to interconnect with AT&T's private lines.[18]

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[15] AT&T Network Distribution System DR 23 (undated AT&T promotional material).

[16] Id. at 4.

[17] These restructured tariff offerings include AT&T's private line tariffs as well as its Software Defined Network ("SDN") and Megacom and Megacom-800 offerings. See Huber Report at 3.41, Table IX.18.

[18] Huber Report at 3.41 n.141.

AT&T told the Public Service Commission in West Virginia that "bypass is readily available today" and that "bypass alternatives exist that are already cheaper than special access charges for very large customers."[19] In Texas, AT&T said:

> "The overwhelming weight of the evidence confirms that facility bypass technology today is in an advanced stage of development, is relatively inexpensive when compared to the cost-reduction opportunities and is readily available to medium and high volume toll users".[20]

In a number of states, AT&T has also presented detailed engineering testimony explaining that bypass technologies are often cheaper than local exchange carrier services.[21]

These numerous opportunities for bypass have undermined the "bottleneck" rationale for the information services and other restrictions in the decree. Any attempt by a BOC to discriminate against competitors would incent those competitors to increase their use of these bypass technologies.

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[19] Testimony of Mary E. Murphy, AT&T, General Rate Case, Docket No. 84-747-T-42T (June 3, 1985).

In Texas, MCI said that "the growing competition in the provision of facilities between interexchange carriers and their customers will no longer permit the subsidy from access service to local exchange services." MCI Brief, 1985 Texas rate case of Southwestern Bell, at 23.

[20] AT&T Brief, 1985 Texas rate case, Southwestern Bell at 14 (Emphasis in original.)

[21] *E.g.*, Testimony and Exhibit B of John D. Schell, AT&T, General Rate Case, Docket No. 84-747-T-42T, June 3, 1985: AT&T Brief, Access Charge Phase, Generic Access Charge Investigation, Pennsylvania Case No. 83-0452, November 19, 1984 at pp. 42-43; Testimony of Robert D. Willig, New Jersey BPU Docket 8312-1126, January 20, 1984; AT&T Reply Comments, Virginia SCC Case PUC 850035, Investigation of Competition for IntraLATA, Interexchange Telephone Service, November 18, 1985.

Further, BOCs have no ability to discriminate by diverging from industry standards because they do not control the manufacture of the equipment necessary for interconnection with the network. As discussed below, even if BOCs manufacture the equipment, they will not have substantial market power in the equipment markets. Therefore, BOCs could not successfully diverge from industry interconnection standards.

As a result of all of these factors, and as the Court decided with respect to AT&T's entry into information services, the BOCs' entry into these technologically sophisticated fields will stimulate competition. BOC entry is therefore likely to produce further technological advances, new products, and better services to the benefit of the American consumer.

In 1982, information services competitors asked the Court for a headstart in developing their market shares before the BOCs entered into these markets. The Court responded by including the information services restriction in the decree. Now, five years later, these competitors, who include some of the largest corporations in the world, have had their headstart, and yet they ask for more. If allowed to compete, the BOCs will start from far behind, with no experience and no market share in the information services markets. There is no justifiable reason to continue to keep the BOCs out of these markets.

2. Manufacturing

The DOJ's Report and Recommendations, including the Huber Report, should dispel any concern that the manufacturing restrictions are necessary. The DOJ has found a post-divestiture fragmentation of BOC purchasing power, a dispersion of network control and an increase in effective regulation. The vibrant competition among the BOCs in this new environment has created real benchmarks for regulatory oversight. While before divestiture it was feared that the BOCs would have a long transition to competitive independence, the last three years have demonstrated otherwise. Thus, today no BOC could realistically discriminate against independent telecommunications equipment suppliers without that discrimination being evident to regulators and the "victimized supplier." Nor would seven inconsistent BOC procurement standards that could only be met by an affiliated BOC manufacturer realistically escape detection.

Predatory pricing is exceedingly unlikely to occur since the competitors in the equipment market are numerous, well-entrenched and at least as well-financed as any BOC manufacturing facility could be. AT&T, for example, through AT&T Technologies, sells billions in equipment each year to various customers, including its regulated interexchange services business. In fact, in 1986, AT&T purchased some $3.7 billion of equipment from its own affiliate.[22] AT&T is not likely to be driven from this market by anyone.

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[22] AT&T 1986 Annual Report at 29.

3. Interexchange Services

Finally, any ability the BOCs might once have had to discriminate effectively in the interexchange market has been eroded by changes in the marketplace. Undoubtedly, for many customers and particularly the small user, the BOC remains and will continue to be the sole provider of local exchange telephone service. In fact, Dr. Huber suggests that without release from the decree's restrictions, in the future the only role of the BOCs will be to serve the small user (Huber at 1.23). But the "single circumstance" that the BOCs continue to serve as the sole provider of local exchange telephone service for small users is not a sufficient basis for restricting the BOCs where other factors such as equal access, effective regulatory controls and market forces stand squarely in the way of transfering local exchange monopoly power to the interexchange telecommunications market.

That market forces would stand in the way of any BOC opportunity to discriminate in interexchange markets is revealed by discussions in other parts of our statement. The discussion directly above on market forces in the information services industry, reveals the many ways in which BOC competitors can bypass the local exchange networks when it is to their advantage to do so. The many activities and statements of AT&T in this regard are particularly important since AT&T continues to dominate the interexchange market. If the BOCs attempted to discriminate against AT&T, it appears axiomatic that AT&T would simply speed-up its plans to develop the bypass technologies it has studied and to use the substantial bypass capacity which it has already developed.

The discussion below under the heading: "Test Number Two", reveals that the interexchange services market is rapidly consolidating around a small group of large facilities-based carriers. This small group, which appears to be raising and lowering prices in tandem, has proven capable of taking care of itself. Any attempt to discriminate against these carriers would be met with bypass and with complaints to regulators.

The question should not be how to protect this group of carriers from new competitors but how to enhance competition in a market that is so dominated by a single provider, namely AT&T. Allowing entry of the BOCs could help achieve the effective competition envisioned by the antitrust laws.

Regulatory Safeguards Would Prevent BOCs From Acting Anticompetitively

The DOJ Report and Recommendations make clear that the BOCs today have no monopoly power in large segments of the telecommunications business. Moreover, assuming market power existed, today's effective regulation neutralizes any remaining ability to exercise such power to sustain an unfair competitive advantage in other markets.[23]

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[23] Regulation has been used to further other important societal policies. In the telephone industry, regulation has promoted the provision of universal service, i.e., the provision of telephone service to all persons at reasonable rates. In essence, universal service has meant that subsidies have been provided, through regulation, to those types of services which the regulator believed should be subsidized. Those subsidies have come from other services for which higher rates have been charged. The evolution of local exchange regulation, of course, must address the problems of universal service in a manner that does not create consumer hardship.

State and Federal regulatory bodies currently regulate the common carrier operations of the BOCs, and entry into the information services and other markets would be subject to sufficient regulatory safeguards. As the DOJ states:

> "In the past, the Commission experienced considerable difficulty penetrating the cost accounting of the integrated Bell System. There are now seven Regional Bell Companies, each separate from AT&T and separate from each other. The decrease in the relative size and complexity of the parties whose costs must be reviewed may make it easier to devise accounting regulations that will more effectively preclude discrimination. Additionally, instead of being faced with a single accounting proposal from an integrated AT&T, the Commission will have the benefit of different accounting proposals from the BOCs and AT&T, each of which will have the incentive to devise a facially effective set of accounting rules." (DOJ, November, 1985, CI-III Comments to the FCC, pp. 41-42)

As the California Public Utilities Commission states:

> "California therefore urges the Court to remove the various restrictions, especially those on information services. By removing the restrictions, the BOCs will be free, under regulatory oversight, to expand their services efficiently to the benefit of ratepayers. California for its part pledges to monitor for cross-subsidies and anticompetitive abuses. This monitoring combined with the antitrust laws themselves, should reasonably protect against anticompetitive concerns. On balance, the cost of oversight and potential for abuses is far outweighed by the benefits created by fully using the local telecommunications network" (CPUC, March 13, 1987, Comments to the Court, at 11).

Finally, as the FCC states:

> "Through several extensive proceedings, this Commission has developed safeguards that will ensure fair, unimpeded competition if the RBOCs are relieved of the decree's absolute entry restrictions. Thus, lifting the decree's restrictions is not tantamount to 'freeing the BOCs.' This Commission has imposed, and will continue to impose, structural safeguards, accounting and other nonstructural safeguards, and conditions on entry to prevent carriers from harming the public or impeding competition as they enter competitive markets. Numerous developments since divestiture affirm this Commission's commitment and ability to protect the public interest and ensure fair competition" (FCC, March 13, 1987, Comments to the Court, at 9-10).

> "Under existing FCC rules and decisions, the BOCs are not free to enter, on an unrestricted basis, information service or equipment manufacturing. Under the guidelines established in Computer III, the BOCs would not be allowed to provide enhanced services (absent complete structural separation) until the Commission has reviewed and approved cost allocation accounting procedures and plans for complying with our CEI/ONA requirements and other nonstructural safeguards. Similarly, under the Joint Cost Order, we require the BOCs to submit for our review and approval cost allocation manuals to separate out from regulated operations the costs of unregulated activities such as equipment manufacturing. In both cases the Commission intends to provide an opportunity for public comment on the BOC plans and manuals as an important part of the review process. ... Mechanisms are thus already in place for this Commission to address competitive entry by the BOCs into manufacturing and information services markets, and these mechanisms provide substantial safeguards against anticompetitive behavior or conduct that otherwise is contrary to the public interest" (FCC, March 13, 1987, Comments to the Court, at 27-28).

The question here is whether the regulatory agencies can do their job. Effective regulation eliminates concerns which have been raised regarding removal of decree restrictions.

In 1982, the Court was reluctant to concede regulatory efficacy.[24] But it is unfair and unrealistic to suggest that regulation today has not progressed far beyond that of the mid-1970s or that regulation of the seven Regions is comparable to the difficulty of regulating AT&T's monolithic pre-divestiture Bell System. The showings by the DOJ and by several of the intervening commissions establish the existence of an alert and effective regulatory environment. A presumption of efficacy applies to the commissions' actions and that presumption is buttressed by considerations of federalism and comity.[25] The bottom line is that absent a compelling showing to the contrary, there is no reason to denigrate the commissions' performances or abilities.

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[24] 552 F. Supp. at 187 n. 229 (The Court suggested that regulation "alone", as it existed before divestiture, could not prevent abuses. Regulation which has developed since divestiture plus the other factors we review certainly can.)

The Court in 1982 made no factual findings of regulatory commission impotence or insufficiency. Quite the contrary, the Court, in recognition, for example, that "regulation of interexchange services will in all probability become more effective", declined to duplicate effective FCC regulatory requirements by repeating them in the decree. (552 F. Supp. at 173, 173 n. 179.)

The state of affairs at the FCC confirms the Court's prediction--its regulation *is* more effective. The protections established by the FCC include dominant carrier regulation, separate subsidiaries, accounting rules, an increased emphasis on cost-based pricing, reasonable unbundling of services and of tariff elements, implementation of equal access, continued regulatory activity to ensure that comparable services and facilities are priced accordingly, detailed cost allocation procedures, sophisticated evaluation of equivalent interconnection standards (including proceedings that seek comparably efficient interconnection for enhanced services), a greater degree of data reporting and reconciliation, and a refined enforcement process. There are also extensive rules for the development and disclosure of network information.

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[25] *Northeastern Tel. Co.* v. *AT&T*, 651 F.2d 76, 90 (2d Cir., 1981).

The history of the state commissions is one of consistent and successful efforts to see to it that subsidies run to the regulated business so that basic rates are kept down. The California Public Utilities Commission has taken and is taking steps to preserve this policy. The California PUC has in the past required purchases of equipment from affiliates to be made on a bid basis and has adjusted the prices paid an affiliated manufacturer for ratemaking purposes in a manner that made affiliated transactions undesirable.[26] The current rules of the CPUC require that the transfer price of goods or services (i.e. services not subject to regulatory tariffs) moving from Pacific Bell to any unregulated affiliate must include a 10% markup, applied on top of full cost or market value, whichever is higher. Pacific Bell must also justify whatever prices it pays to any such affiliated business for any goods or services.[27] The CPUC is continuing its examination of Pacific Bell's relationships with its non-regulated affiliated companies and can be expected to fully protect Pacific Bell's ratepayers. In the recent past, the Court has correctly noted that "it appears that the California Public Utilities Commission is particularly vigilant of cross-subsidization".[28]

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[26] General Telephone Co. v. PUC, 34 Cal. 3d 847 (1983); Pacific Tel. & Tel. Co. v. PUC, 62 Cal. 2d 634, 659-662 (1965).

[27] In Re Pacific Bell (Decision No. 86-01-026) ___ Cal. PUC 3d ___ (1986).

[28] 1986-1 Trade Cases at p. 62057 (1986). (Pacific Telesis - CI acquisition).

In sum, an antitrust court should not regulate any part of an industry unless there is regulatory failure. Regulation in the telecommunications industry and with regards to activities of the BOCs is working. The Court should remove the decree restrictions and let regulators get on with their work under the guidance of Congress and state legislatures.

TEST NUMBER TWO

REMOVAL OF THE RESTRICTIONS WILL CREATE COMPETITION AND BENEFIT CONSUMERS

The second question to be answered in determining whether restrictions should be removed under Section VIII(C) of the decree is: "Will participation by the BOCs contribute to the creation of competition?"

1. Information Services

Lifting the decree prohibition on information services will result in seven potential new entrants in the market. Their ability to enter will in itself provide competitive pressure, resulting in improved services and lower prices for consumers not only of information services provided by the BOCs but also of competing information services provided by others and of the many market substitutes.

The information services restriction prevents BOCs from providing many advanced services which could be offered more efficiently through integration with the public switched telecommunications network (DOJ Report at 113). Absent such integration, the cost of such services may continue to make them unavailable to residential and small business consumers. Moreover, while large businesses may be able to build private networks or purchase necessary customer premises equipment (CPE) or computers to provide such services, these businesses may needlessly be incurring upfront capital outlays and risks of equipment obsolescence.[29] For example, residential and small business customers cannot currently obtain certain network-based voice messaging[30] capability at reasonable rates or in a useful manner (Huber at 10.13). A business customer who owns a private branch exchange (PBX) can upgrade the PBX equipment and thereby have access to voice messaging (Huber at 10.1). But a residential customer or a small business customer does not have this option. Through economies of scope and scale, Pacific Bell and Nevada Bell could offer this service directly through the telephone set on a widely available,

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[29] In their March 13, 1987, Comments to the Court some intervenors speculate that there may be no consumer demand for the information services a BOC might offer (See Ad Hoc (Continued on next page)

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[29] continued,

Telecommunications Users Committee at 62-65; ANPA at 20). However, others state that the decree restrictions inhibit the development of services (See, e.g., Videotex Industry Association at 2-3, 4-5, 7-12; California Public Utilities Commission at 10). Unless the BOCs are permitted to offer the services, no one will ever know for certain how much consumer demand exists. In the unlikely event that no consumer demand exists, then allowing BOC provision does no competitive harm. However, if consumers are being denied services they would want, then economic losses are occurring and the consumers are being injured. The existence of demand is clearly demonstrated by an opponent of allowing the BOCs to provide information services which also complains that the BOCs do not deliver the information it desires electronically instead of in hard copy form (Dun & Bradstreet at 34-36). Removal of the restriction would allow BOCs to provide such delivery.

[30] Voice messaging allows a user of a voice storage and retrieval system to leave a message for other users on the system. The user can send group broadcasts simultaneously and can easily reply to the sender of a message or redirect a message to a third party on the system. A residential consumer might choose to use this service, for example, to communicate a notice of a meeting to a group of people in an efficient manner. A business consumer might use it to send messages to groups of suppliers and customers and to receive responses. If the intelligence were allowed to be put in the network, consumers could access these services through a telephone set, without purchase of additional equipment.

affordable basis to those customers, if the decree did not prevent integration of intelligence with their networks.[31]

The fact that large business customers choose to integrate these services into their PBXs, or "private switches", is strong evidence of the efficiencies gained through integration (DOJ Report at 114). Removal of the decree restriction would mean that residential and small business customers could, through the BOCs' large centralized network switches, obtain these same efficiencies.

BOC entry could stimulate technological advances not only in information services but also in the equipment used to provide the services.[32] Stimulated use of these services would give manufacturers of the equipment an incentive to develop more technically advanced equipment with greater capacity. In turn, such technically advanced equipment could improve the economics of providing the services, giving consumers further benefits.

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[31] Through economies of scale and scope, Pacific Bell and Nevada Bell are able to offer many services at a price less than other providers. So long as that price is above the incremental cost of producing the service there is no antitrust concern (See,e.g., Northeastern Tel. Co. v. AT&T, 651 F.2d 76, 90 (2nd Cir. 1981).

Pacific Bell and Nevada Bell believe that there are numerous information services which they could make more widely available to consumers, if it were not for the information services restriction. These include: voice mail; electronic mail; access to various videotext services, including financial and other data retrieval services; services which transfer text to speech, and vice versa, to help persons with hearing and speech disabilities to more fully communicate; improved security alarm services; health monitoring; remote classroom; "electronic county agent"; interactive services to deliver public services to rural areas; and improved telecommuting services. See September 23, 1986, Testimony of Pacific Telesis Group before the Senate Committee on Commerce, Science, and Transportation.

[32] See generally, March 13, 1987, Comments of Rural Telephone Coalition at 6-8.

Many services not available in the United States are currently available in other countries (Huber at 6.43-6.46). Absent the decree restrictions, the BOCs could offer those services to residential or small business customers so that those customers could participate in the Information Age to the same extent as their foreign counterparts.

2. Manufacturing

The entry of BOCs into manufacturing will stimulate competition. Those who oppose BOC entry seek to protect their competitive positions--to protect their market shares, not the process of competition. AT&T, for example, seeks protection for the combination of AT&T-Olivetti-N.V. Philips-Lucky Gold Star-Toshiba-Ricoh (AT&T's Italian, Dutch, Korean and Japanese partners) from the prospect that BOCs may form joint ventures with some as yet unidentified foreign manufacturers.[33]

As the above discussion under the heading: "Test Number One", makes clear, the entry of BOCs into the extremely competitive telecommunications equipment manufacturing market could not

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[33] AT&T has entered into various manufacturing joint ventures and distribution agreements with these foreign corporations. At the same time, AT&T opposes the DOJ's recommendations for removal of restrictions arguing that such action would "further weaken the U.S.

(Continued on next page)

possibly harm competition. In addition, the March 13, 1987, Comments to the Court reveal niche areas where the introduction of BOC expertise could promote competition and benefit users of telecommunications equipment.

For example, Verilink, a manufacturer of telephone diagnostic and test equipment, including network channel termination equipment (NCTE), points out that the restriction is slowing BOC attempts to coordinate NCTE and network changes, thereby slowing network improvements (pp.6-7). Stantel a manufacturer of high technology telecommunications equipment and CPE argues that the restriction has a chilling effect on the BOCs bringing their considerable experience and expertise to research, development, design, engineering and testing of equipment (pp.24-25).

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[33] continued,
international trade". Statement of Edward D. McKeever, Vice President of AT&T International, before the Subcommittee on Commerce, Consumer Protection and Competitiveness (March 5, 1987). On February 2, 1987, AT&T issued a statement in response to the DOJ which said:

> "We also cannot understand why the Justice Department would choose this time in our history to propose a set of conditions where millions of American customers might find themselves underwriting foreign manufacturers."

In March of 1987, AT&T circulated a position paper entitled: "RBOC Manufacturing and the Trade Issue", which stated: "...the most logical thing for [BOCs] to do would be to form joint ventures whith one of the major global manufacturers, all of whom are foreign except AT&T".

3. Interexchange Services

AT&T and MCI assert that the presence of 500 interexchange competitors shows competitive health and the lack of any need for BOC competition. But the resellers' trade association points out that 95 percent of those 500 competitors are (or were) resellers and that the Association has lost members. This is symptomatic of what is well understood in the industry--a very large number of resellers have already gone out of business and more are on the way.[34] Only three facilities-based carriers are nation-wide and only five others serve as many as 25 states.[35]

AT&T and MCI also assert that interexchange rates have dropped 30% and imply that this as due to competitive pressures. But in its current Annual Report to shareholders AT&T admits it was regulation, not competition, that forced reduced prices:

> "Service revenues rose due to growth in long distance calling volumes, stimulated in part by AT&T's substantial rate cuts in each of the past three years. The rate cuts resulted primarily from reductions in connection fees charged to AT&T by local telephone companies.
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> "To target the new [reduced] rate of return and reflect reductions in access charges, AT&T lowered prices significantly on January 1, 1987." (AT&T 1986 Annual Report, pp. 15-16, dated Feb. 9, 1987.)

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[34] Alternative Carriers Telecommunications Association, at 4,5-6.

[35] *Ibid.*

MCI is troubled that FCC regulation will drive interstate rates down farther and sees deregulation of AT&T as in MCI's interest.[36] AT&T's Chairman responded by saying that if AT&T is deregulated: "Frankly, it will be better for everyone, including our competitors".[37] No doubt this is true, but it is not indicative of effective competition.

The MFJ ban on BOC competition between the United States and the rest of the international market, where AT&T is totally dominant, does not preserve competition, it prevents competition. The BOCs have no inherent advantage in entering international markets.

To the contrary, they will enter such markets under enormous handicaps, just as they will face formidable odds if they attempt to enter the domestic interexchange market in head-to-head competition with AT&T, MCI, Sprint and others who have had the benefits of the presubscription balloting process. Permitting Pacific Telesis and the other Regions to compete in the interexchange market will contribute to lasting, healthy competition.

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[36] "New MCI Strategy: Deregulate AT&T", New York Times, March 6, 1987, p. 36: "MCI Asks U.S. to Free AT&T From Controls", Wall Street Journal, March 6, 1986, p. 10. See discussion, Comments to the Court of Pacific Telesis Group (March 13, 1987) at 12-13.

[37] Wall Street Journal, March 23, 1987, p. 6.

TEST NUMBER THREE

THE RESTRICTIONS ARE HAVING DETRIMENTAL EFFECTS ON OTHER IMPORTANT PUBLIC POLICIES

The third question to be answered in determining whether restrictions should be removed under Section VIII(C) of the decree is: "What is the effect of the restrictions upon other important public policies?"

First Amendment Rights

The First Amendment protects Pacific Telesis' right to provide content by way of information services. Protected content includes commercial advertising, stock quotations, sports tables, directory listings, editorials, news stories, and feature stories.

Content that is "related solely to the economic interests of the speaker and its audience" (or "commercial speech") is protected by the First Amendment,[38] although the protection is somewhat less extensive than that afforded "noncommercial speech".[39] Commercial speech "not only serves the economic interest of the speaker, but also assists consumers and furthers the societal interest in the fullest possible dissemination of information" (Id.). First Amendment rights apply when Pacific Telesis seeks to offer information created by others or by itself.[40]

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[38] Central Hudson Gas & Electric Corporation v. PSC, 447 U.S. 557, 561, ___ (1980).

[39] Zauderer v. Office of Disciplinary Counsel, 471 U.S. ___, 85 L.Ed.2d 652, 653 (1985); Ohralik v. Ohio State Bar Assn., 436 U.S. 447, 456 (1978).

[40] See Preferred Communications, Inc. v. City of Los Angeles, 754 F.2d 1396, 1410, n.10 (9th Cir. 1985), affd in City of Los Angeles Dept. of Water and Power v. Preferred Comm., Inc., 476 U.S. ___, 90 L.Ed.2d 480 (1986).

The Court should permit rather than deny, consumers the use of Pacific Telesis' information services capabilities to disseminate information. That is, the Court should "open the channels of communication rather than close them", as required by the First Amendment. In Weaver v. Jordan, 64 Cal.2d 235, 241-43 (1966), the court summarized the law as follows:

> "In as much as the rights of free speech and press are worthless without an effective means of expression, the guaranty extends to both the content of the communication and the means employed for its dissemination.
>
> . . . .
>
> "The right of freedom of speech and press includes not only the right to utter or to print, but the right to distribute, the right to receive, the right to read...." (Citations omitted).

The continued MFJ prohibition on Pacific Telesis' provision of information services runs counter to the First Amendment, affecting not only the BOCs but the public generally (DOJ Report at 137, fn. 273).

Some intervenors disagree with the DOJ's conclusion that retaining the ban on electronic publishing by the BOCs is contrary to the diversity goals underlying the First Amendment. The American

Newspaper Association (ANPA) argues that the prohibition promotes diversity[41]. ANPA assumes that the prohibition is necessary to eliminate competitive concerns (ANPA March 13, 1987, Comments to the Court, at 12-13, fn. 40). However, as discussed above in the section of this statement entitled: "Test Number One: The BOCs Do Not Have The Incentive and Opportunity To Act anticompetitively", the DOJ's Report shows that ANPA's assumption is incorrect. And regulators have made it clear that they can protect competition and consumers through the use of accounting and other safeguards. Therefore, there is no reason to retain the ban to protect the First Amendment rights of others.

The Government's Report and the Huber Report document that the information services industry is diverse, operating to an increasingly large extent outside of the local telephone network. Channels of communication for information services appear to be multiplying.

In any event, expressed concern about monopoly characteristics and economic constraints on competition (768 F.2d at 1449), such as those voiced by ANPA, cannot justify restrictions upon speech. As the Court of Appeals in Quincy[42] stated:

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[41] ANPA's opposition is true to its historical stance. As Congressman Thomas Tauke noted, ANPA's opposition "kind of hearkens back to when radio first came in, and the newspaper publishers asked Congress for a prohibition of news on the radio, [asking that] you couldn't read the news on the radio" (Editor & Publisher at 32 (3/28/87). See Lorain Journal vs. U.S., 342 U.S. 143 (1951).

[42] Quincy Cable T.V., Inc. v. FCC, 768 F. 2d 1434 (D.C. ar. 1985) cert. den.___U.S.___, 90 L Ed. 2d 177, 106 S.Ct. 2889 (June 9, 1986) (voiding the FCC "must carry" rules which required cable operators to carry local programming).

> "the Supreme Court has categorically rejected the suggestion that purely economic constraints on the number of voices available in a given community justify otherwise unwarranted intrusions into First Amendment rights (Miami Herald Publishing Co. v. Tornillo, 418 U.S. 241, 247-256, 94 S.Ct. 2831, 2834-39, 41 L.Ed.2d 730 (1974)". 768 F.2d at 1450.

The Court of Appeals further relied upon the statement of the United States Supreme Court in Buckley v. Valeo, 44 U.S. 1, 48-49 (1976), that:

> "the concept that government may restrict the speech of some elements of society in order to enhance the relative voice of others is wholly foreign to the First Amendment."

Accordingly, silencing Pacific to enhance ANPA's voice "is wholly foreign to the First Amendment."

The information services restriction also violates the First Amendment because it is over inclusive. Less restrictive means of regulation are available, including oversight by Federal and State commissions and the availability of an antitrust remedy after antitrust harm occurs if any were to occur.[43]

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[43] The California Supreme Court, in voiding a publicly passed state proposition to ban cable television on the grounds it would drive out "free" television, stated:

> "If monopoly practices appear or if the public interest actually suffers or is ignored it will then be time enough to apply appropriate regulation within constitutionally permissible limits. But the outright ban here undertaken by the Act cannot stand. As pointed out in Wollam v. City of Palm Springs, supra (1963) 59 Cal.2d 276, 284, 'the right to regulate [a means of communication] does not necessarily sanction the outright prohibition.' And as stated in Shelton v. Tucker (1960) 364 U.S. 479, 488; [81 S.Ct. 247, 5 L.Ed.2d 231], 'even though the governmental purpose be legitimate and substantial, that purpose cannot be pursued by means that broadly stifle fundamental personal liberties when the end can be more narrowly achieved." Weaver v. Jordan, 64 Cal.2d 235, (1966).

The ability to express views by other means is insufficient to justify the ban on electronic publishing. As illustrated by Quincy, the First Amendment protects carriage as well as content, and an outright ban on a channel of communication cannot stand when less restrictive means of regulation are available, even if other channels of communication are available. It is not sufficient that the BOCs can communicate through the press or through the channels of others since they have a First Amendment right to communicate directly.

Because of the over inclusive nature of the prohibition on provision of content and because of the lack of a substantial governmental interest, the First Amendment directs the Court to remove the MFJ prohibition on Pacific Telesis' provision of information services.

Technological Development

There is another aspect of public policy that Pacific Telesis believes should weigh importantly in the evaluation of the DOJ's recommendations. Dr. Huber has had the foresight to recognize that the BOCs cannot continue effectively to serve large and small customers alike and to keep abreast of technology if they remain closely and, we submit, unjustifiably confined. His prediction of things to come if the BOCs are not permitted to participate, and to help their customers participate, in the technological revolution that is already well underway provides a sobering backdrop to any analysis of the future role of the line of business restrictions:

> "Whatever the Regional Bell Operating Companies are or are not permitted to do, the Modified Final Judgment's basic vision of a horizontally stratified telecommunications marketplace, animated by an obsolescent model of the network as a pyramid, will not survive. AT&T, IBM, and other major U.S. and foreign telecommunications and electronics companies are already gathering for the wake." (Huber, p. 1.2)
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> "AT&T undoubtedly recognized this clearly when it agreed to surrender the heart of its old network for permission to participate fully in building the new one." (Huber, p. 1.6)
>
> "Each [non-BOC] firm is systematically and methodically assembling every one of the corporate pieces so familiar to students of AT&T's pre-divestiture structure." (Huber, p. 1.7)
>
> "The RBOCs are profitable today, more so than many of the other companies that are busily investing, acquiring, and building for the future. But without exception, RBOC business planners recognize the freedom to compete as system integrators for large business customers is essential to their long-term stability and profitability. While there can be a good bit of disagreement about what time frame the long term represents, their assessment is unquestionably correct." (Huber, p. 1.23)
>
> "The other major carriers can build around the RBOCs. They will resell RBOC services while they do, and then migrate major customers on to fully independent, end-to-end, service networks when the job is completed." (Huber, p. 1.23)
>
> "And of course the RBOCs will remain system integrators for the poor, the tired, and the hungry. But this undoubtedly important responsibility is one that few for-profit companies will choose as their only one. It remains quite possible that the RBOCs will become the U.S. Post Office of electronic telecommunications, absolutely essential to many, with steady or even growing traffic, shored up by an obsolete statutory monopoly, but moribund nonetheless." (Huber, p. 1.23).

Of particular concern to Pacific Telesis is any adverse effect of the decree on our technological development. The Huber Report pinpoints and increases this fear:

> "...[T]he MFJ and the FCC have heretofore defined basic exchange services by reference to history. By and large, the regulatory definitions have attempted to freeze network 'processing,' 'transforming' and 'storage' at the point where they stood in 1956, when the first AT&T Consent Decree was signed and AT&T largely stopped adding user-visible features to its network. The most complex and sophisticated processing in the network is thus permitted, but only to multiplex and route voice calls, not to process inter-machine communications which were unknown in 1956. High-level code and protocol conversion in the network is permitted, but only so long as it reformats signals generated by a rotary dial or a touchtone keypad, not by a keyboard or a computer. Recorded messages may be stored and retrieved in the network, but only if they involve the melifluous 'I am sorry, the number you have reached is not in service.' These lines have no economic or technological content. They are instead a monument to history." (Huber Report, p. 6.4-6.5).

The Court in 1982 shared this concern and twice asserted that the BOCs should not become "technological backwaters" (552 F.Supp. at 169 and 190).

CONCLUSION

Retention of the decree's line of business restrictions does not just hurt the BOCs, it hurts consumers and the nation. One example, the facts of which are beyond reasonable dispute, makes the point:

> "Domestically and abroad, low-level electronic information services have penetrated much more deeply into the exchanges not owned by the RBOCs.
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>
> "Why haven't U.S. [local exchange companies] followed suit? Certainly one sufficient factor might have been the different customer bases served ... But regulatory barriers imposed by the 1956 Decree, the FCC, and the MFJ, have undoubtedly been a second and quite sufficient factor on their own, especially for the low-level information services that would be sold 'by the drink' in the mass market, for a few cents or dollars". (Huber, pp. 6.46-47.)

Congress should urge the Court to remove the restrictions unconditionally. Once the decree restrictions are gone, Congress will once again be in the position to set national telecommunications policy to be carried out by the FCC, and States will be able to implement their telecommunications policies. Benefits of this policy will accrue to consumers and our nation.

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

United States of America, Plaintiff, v. Western Electric Company, et. al., Defendants.	Civil Action No. 82-0192

Joint Comments of National Consumers League Black Citizens for a Fair Media and the Council of Churches of New York City National Association of State Universities and Land Grant Colleges Native American Public Broadcasting Consortium and the National Indian Youth Council Office of Communications of the Church Federation of Greater Chicago Consumer Interest Research Institute Public Interest Computer Association and National Association for Better Broadcasting

The National Consumers League ("NCL"), Black Citizens for a Fair Media ("BCFM") and the Council of Churches of New York City ("COC"), the National Association of State Universities and Land Grant Colleges ("NASULGC"), the Native American Public Broadcasting Consortium ("NAPBC") and the National Indian Youth Council ("NIYC"), the Office of Communications of the Church Federation of Greater Chicago ("OCC"), the Consumer Interest Research Institute ("CIRI"), the Public Interest Computer Association ("PICA"), and the National Association for Better Broadcasting ("NABB") (collectively referred to as the "Joint

Commenters"), by their undersigned attorneys, hereby submit their comments on "The Report and Recommendations of the United States Concerning the Line-of-Business Restrictions Imposed in the Bell Operating Companies by the Modified Final Judgment" (hereinafter referred to as the "Justice Report").

The Joint Commenters, whose members are users of telecommunications services and equipment, have focused their comments on the costs to society of the information services restriction contained in the Modified Final Judgment ("MFJ"), 1/ centering on the impact of the restriction on the equitable distribution of telecommunications technology, specifically including information services, as it evolves in the Information Age throughout all sectors of the country, regardless of income level, race, sex or religion. In addition, the Joint Commenters have addressed the mechanisms for ratepayer protection which should be employed if the information services restriction is removed to minimize the risks of cross subsidy and discrimination in access by the Bell Operating Companies ("BOCs").

1/ *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131, 189-90 (D.D.C. 1982), *aff'd mem. sub nom. Maryland v. United States*, 4660 U.S 1001 (1983).

I. Overview

Before turning to the merits of lifting the information services restriction, the Joint Commenters wish to present brief background information on each of the member groups; set forth a concise procedural history and statement of the issues at stake in this proceeding; and explain the overall values and concerns of "citizen users" which this Court should consider in deciding whether, and how, to lift the information services restriction contained in the MFJ.

A. Description of Groups

The Joint Commenters are a diverse group of organizations, each of which has members who use telecommunications services and equipment. These organizations include the only minority groups which are parties to the proceeding, namely Black Citizens for a Fair Media, the Native American Public Broadcasting Consortium and the National Indian Youth Council. See Applications for Intervention of Black Citizens for a Fair Media and Council of Churches, and the Native American Public Broadcasting Consortium and the National Indian Youth Council (filed February 20, 1987). Similarly, the nation's oldest consumer group, the National Consumers League, with over 5,000 members who use telecommunications services and equipment, is one of the Joint Commenters. See Application for Intervention of National Consumers League (filed February 20, 1987) at 1.

The Joint Commenters also count in their number organizations which are heavy users of information services for a variety of purposes. One member is a group of the nation's leading public institutions of higher education (the National Association of State Universities and Land Grant Colleges), whose members operate over 80 different communication networks, and which house many of the nation's supercomputers. See Application for Intervention of National Association of State Universities and Land Grant Colleges (filed February 20, 1987) at 2.2/ In addition, the Joint Commenters include the Public Interest Computer Association, a group which is both a user and a provider of information services. See Application for Intervention of Public Interest Computer Association (filed February 20, 1987) at 1-2.

The Joint Commenters also include groups whose members are telecommunications users and who are also interested in ensuring an equitable distribution of telecommunications technology, including information services, at affordable prices, including the Council of Churches of the City of New York and the Office of Communications of the Church Federation of Greater Chicago. See Applications for Intervention of Black Citizens for a Fair Media

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2/ In addition, the American Council on Education, which was unable to file a petition for intervention on February 10, 1987, has reviewed this submission and supports the position taken herein by NASULGC. ACE is the umbrella trade association representing more than 2,000 institutions of higher learning, covering two and four year public and private institutions.

and the Council of Churches, and the Office of Communications of the Church Federation of Greater Chicago (filed February 20, 1987).

Last, the Joint Commenters include a nonprofit corporation which analyzes public policies from a consumer perspective (the Consumer Interest Research Institute) and an organization devoted to quality telecommunications service (the National Association for Better Broadcasting). *See* Applications for Intervention of the Consumer Interest Research Institute and the National Association for Better Broadcasting (filed February 20, 1987). What these groups all share is the citizen user perspective on the issues before this Court, specifically, a common concern that the full potential of high quality, innovative telecommunications services be made available to all citizens, regardless of income level, race, sex or religion, at affordable prices.

B. *Procedural History and Statement of Issues*

This proceeding has its immediate roots in the divestiture of the American Telephone and Telegraph Company ("AT&T"), as modified and approved by this Court pursuant to the Tunney Act, 15 U.S.C.§16(e). *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131 (D.C.C. 1982), *aff'd mem. sub nom. Maryland v. United States*, 460 U.S. 1001 (1983). The divestiture, which was the largest corporate reorganization in American history, sprung from a history of antitrust litigation brought by the United States against AT&T dating back to 1949. *Id.* at 135. *See also*

United States v. Western Electric Co., Inc., 569 F. Supp. 1057, 1120 n. 284 (D.D.C. 1983), aff'd sub nom. California v. United States, 464 U.S.§1013 (1983). More specifically, the government brought an antitrust action against AT&T, Western Electric and Bell Telephone Laboratories in 1974 for monopolization of a variety of telecommunications services and equipment in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2, and the divestiture of the BOCs from AT&T was sought. United States v. American Tel. and Tel. Co., 552 F. Supp. at 139. This case was settled between the parties in January of 1982 with a proposed consent decree which provided for divestiture, and it is that proposed consent decree which this Court modified and approved in the form of the MFJ. Id. at 140-143.

The fundamental theory justifying the divestiture was that AT&T was able to exercise monopoly power and block competition in the long distance and telecommunications equipment markets because of its control over local exchange facilities. Id. at 162, 165. Without control of the BOCs, the Court reasoned that AT&T could not disadvantage long distance competitors by cross subsidizing its long distance rates with revenues from monopoly local service or provide competition with inferior access. Id. at 165. Furthermore, the divested BOCs would not have incentives to favor Western Electric over other equipment manufacturers. Id. at 165-166.

This Court imposed restrictions on the BOCs to prevent them from thwarting competition by "leveraging their monopoly power in the intraexchange telecommunications market." Id. at 187. As the Court stated, "[t]he restrictions are based upon the assumption that the Operating Companies, were they allowed to enter the forbidden markets, would use their monopoly power in anticompetitive manner." Id. Thus, based upon the evidentiary record of AT&T's practices, the BOCs were prevented from providing interexchange services and from engaging in the manufacture of telecommunications equipment. Id. at 188-189, 190-191. In addition, without any specific, detailed evidentiary record of past practices, but based on fears that analogous abuses might occur in the future, the BOCs were prohibited from supplying information services. Id. at 189-190.[3/] Consequently, the Court noted that without the information services restriction, the incentive of the BOCs would be "to design their local networks to discourage competitors, and thus to thwart the development of a healthy, competitive market." Id. at 189-190. Another perceived rationale for the restriction was to guard against the threat of cross subsidy from revenues from monopoly "plain old telephone service" ("POTS"). Id. at 189.

The issue at stake in this proceeding is whether this reasoning holds true today -- i.e., whether the potential harms to society from removal of the restrictions outweigh the actual costs to society arising out of the restrictions. Much has

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[3/] See also P. Huber, The Geodesic Network- 1987 Report on Competition in the Telephone Industry (hereinafter referred to as the "Huber Report") at 6.15, 6.30.

changed since the divestiture of AT&T. The telecommunications markets literally have been turned upside down. Equal access has been implemented. The BOCs, through a waiver process closely managed by this Court, have engaged in a host of competitive activities. And, most importantly, a veritable revolution in telecommunications and computer technology is under way. All of this makes the time ripe for the full and detailed review of the MFJ's restrictions which is the basis of the instant proceeding.

C. Values and Concerns of Citizen Users

In exercising its responsibilities pursuant to the Tunney Act, this Court sought to achieve three major objectives: (1) promotion of competitive long distance and telecommunications equipment markets; (2) preservation of AT&T as a dynamic force; and (3) protection of the principle of universal telephone service. United States v. Western Electric Co., Inc., 569 F. Supp. at 1120. The Joint Commenters respectfully submit that, in deciding whether to remove the information services restriction in the MFJ, this Court should conclude that universal service must encompass assurance of the most widespread, equitable distribution of information services to all citizens, regardless of income level, race, sex or religion, at affordable prices.

To be sure, consumers want and deserve high quality, universal voice telephone service. But in the Information Age, that is simply not enough. The Joint Commenters are deeply concerned that there not be allowed to develop in this nation an "information aristocracy," whereby the "information rich" have access to a wide range of innovative services, and the "information poor" are left with nothing but an antiquated and deteriorating network, barely adequate even for POTS. As technological innovation occurs in the telecommunications industry, all users, small and large, and corporate and residential alike, should be able to share the benefits.

The Joint Commenters are decidedly not espousing any novel egalitarian ethic. Rather, we simply believe that the hypothetical harms which motivated the imposition of the MFJ's restrictions originally (and which could possibly occur if the information services restriction is removed) should not be viewed in isolation. The complete picture necessarily includes the variety of innovative services which could be made available more widely and on a more affordable basis if the restriction is removed. And, most importantly, all types of users (including the diversity of groups comprising the Joint Commenters) stand to gain significantly from the offering of these services by the BOCs. A full discussion of the benefits for users is presented in Section II, below.

The Joint Commenters believe strongly that ratepayers must be protected if the restrictions are removed. It would be folly for this Court to remove the information services restriction without incorporating specific mechanisms in the order resulting from this proceeding to protect ratepayers against the harms which animated imposition of the restrictions in the first place. As the Court noted in its opinion approving the MFJ, if the BOCs are allowed to offer information services, there is a risk that they could discriminate against competing information service providers by providing them with less favorable access to the local exchange. United States v. American Tel. and Tel. Co., 552 F. Supp. at 189. But this risk of discrimination can be minimized through requirements of open network architecture ("ONA") and comparably equivalent interconnection ("CEI"). As to the a risk that the BOCs could cross-subsidize their entry into the information services market through their local rate bases, the enforcement of, accounting standards and other safeguards can minimize that risk. Last, the impact of removing the restriction on local rates can be made positive by requiring that the price of access to the local network for the provision of information services include a contribution to cover a portion of the non-traffic sensitive costs. A full discussion of the types of protections which the Joint Commenters believe are necessary is set out in Section III below.

Overall, the Joint Commenters believe that the issues involved in this Court's determination of whether to continue the restrictions in the MFJ are neither simple nor clear. But it is certain that today's American telecommunications industry is undergoing rapid, dramatic changes. No one can predict with certainty where these changes will lead. Therefore, Joint Commenters propose an annual review mechanism designed to provide both Department of Justice and Court supervision of the implementation process.

It is apparent that the information services restriction is imposing very real costs on users and the public, and the harms which motivated imposition of the restriction can be minimized. Under these circumstances, and with the protections and review process which the Joint Commenters urge, this Court is respectfully requested to remove the information services restriction from the MFJ.

II. The Information Services Restriction: What It Has Cost And Why It Should Be Lifted

A. Introduction

The Joint Commenters support the DOJ's proposal that this Court lift the information services restriction, subject to the protections described in Section III. Joint Commenters agree with DOJ that the restriction is vague and overbroad in its impact; that the harms to ratepayers and competition it is intended to prevent can be minimized or avoided through appropriate regulatory and judicial mechanisms; and that the restriction has imposed costs on all segments of society, from the small, non-profit and citizen users--by retarding the development and exploitation of appropriate technology in the United States--to the large users, such as university and college community, by limiting access to competitive telecommunication offerings.

The existence of this restriction, moreover, has unfortunately contributed to the development of a division among users, in effect pitting enhanced or data users against voice users. Not only is there a rapidly growing gap between the information "haves" and the information "have nots", but there is also a growing constituency for the idea that the elderly, the minority population, the low income and other vulnerable populations do not "need, want or require" access to more advanced technology. The restriction reinforces a paternalistic stereotyping of consumer interests. Its existence supports the notion that the local network is and should be like a "dumb terminal," suitable for transmission of data or voice, but with no intelligence or other enhanced capacities -- a passive network in which any advanced services must be offered either through expensive customer premises equipment or by enhanced service providers separate from the telephone company. This notion has contributed to at least a perceived difference between the interests of voice and data users in the network. It has also contributed, Joint Commenters submit, to a lack of overall public receptivity to newer information technologies. This joint filing, however, is itself an indication that such a division is inappropriate and that the interests of citizen users and large institutional users are not incompatible.

The record now before the Court (including the Huber Report), and the Federal Communications Commission ("FCC") program of CEI, ONA and accounting safeguards, establish that this Court can carefully lift the information services restriction at this time with minimum risk of harm to the consumer and to competition, while the benefits of increased access to an array of more appropriate technologies to the consumer will be promoted. Commenters submit that, reasonably implemented, the development of information services will open up a whole new world of services to the citizen user, promote competition for services to larger users, and prove to be a new source of contribution to the non-traffic sensitive costs of the local network.

As was pointed out accurately in the Justice Report, the information services restriction is different from the other two restrictions. [4/] Rather than a direct response to established violations, it was an elliptical and defensive response by DOJ and the Court to feared potential antitrust harms in the provision of information services over the local network. See United States v. American Tel. and Tel. Company, 552 F.Supp. at 189-190; Huber Report at 6.15; Justice Report at 108-109. And while that view may have been warranted in 1982, it is clear now that there are substantial differences between information services and the other restrictions.

B. Unintended Results

As the Huber Report and the Justice Report demonstrate,

[4/] Justice Report at 108.

there was only a limited understanding of the nature and breadth of the information services restriction when it was imposed. Huber Report at 6.1 n.1; Justice Report at 108. While it was intended to be "absolute," it is not certain precisely what was absolutely prohibited, other than electronic publishing. [5] Id. With the passage of time, the restriction has discouraged the development of new information products and services. Justice Report at 113-121.

The Joint Commenters respectfully suggest to the Court that there has been a major cost to the public in terms of denial of services that can best be offered directly through the local network. Further, this cost is mounting, as information services increase in value and usefulness as a source of political, social and cultural information.

Few users, whether non-profit groups, small businesses, colleges, or citizen users, have been well served by the changes in the telecommunications industry and regulatory framework over the past three years. The paradigm of the MFJ, which might have prevented the development of what has become a "lose-lose" situation for most consumers, was shattered even before it was implemented. [6] The original concept was that of a monopoly local exchange company selling local service at the "front end," while also selling exchange access service at the "back end" of the network. Such a system would work because (1) the local exchange company would be devoted exclusively to the offering of high-quality, low cost exchange service; and (2) the cost of the local exchange, including the cost of the local loop, would be paid for in significant part by the charges paid for by those purchasing exchange access. At that time, the universe of customers for exchange access consisted almost exclusively of the interexchange industry.

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[5] At the time, the prohibition may well have been intended to parallel the FCC's Computer II separate subsidiary requirement, prohibiting those services that would be considered "enhanced" by Computer II terms. See Huber Report at 6.1 n.1; Justice Report at 107 n.220.

[6] Cf. United States v. Western Electric Co., Inc., 569 F.
(continued...)

Thereafter, however, the FCC announced its program whereby the local exchange customer would pay for access to the long distance network through the imposition of subscriber line charges, instead of the interexchange companies paying for access to the exchange customer. Third Report and Order, supra. The regulatory and market developments over these past three years have been perverse from the small user's perspective. While the introduction of competition has led to repricing and the shifting of costs toward the local exchange customer, there have been few concomitant benefits to the local exchange customer, except to

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6/(...continued)
Supp. at 1091; MTS/WATS Market Structure (Phase I), Third Report and Order, 93 FCC 2d 241 (1983), modified on recon., 97 FCC 2d 682, further modified on recon. 97 FCC 2d 834, aff'd in principal part and remanded in part, National Ass's of Regulatory Util. Comm'rs v. FCC, 737 F2d 1095 S. Ct. 1224 (1985), modified on further recon. 99 FCC 2d 708 (1984), 100 FCC 2d 899 (1985), appeal docketed, U.S. Telephone, Inc. v. FCC, Wo. 94-115 (D.C. Cir. March 23, 1984) (hereinafter "Third Report and Order").

the extent that they may be heavy users of inter-exchange long distance services. [7] In terms of new products and services, the benefits have flowed primarily toward the large users. [8]

On the local level, the introduction of Shared Tenant Services (STS) to residential complexes has been delayed while the nature of the local franchise has been studied. See, e.g., Proceeding on Motion to Review Regulatory Policies for Segments of the Telecommunications Industry Subject to Competition, Case 29469 (N.Y. Pub. Svc. Comm'n), 1987. On the national level, the offering of low cost information services directly to the local exchange customer through the network has been totally prohibited, limiting access to those services to corporations and other large scale users with the resources to purchase expensive CPE.

The college and university members of NASULGC also have not been well served by the information services restriction. The largest of the members are among the most sophisticated and heaviest users of advanced telecommunications services. For them, the need is for high quality, digital communication services on competitive terms. The information services restriction on the BOCs has limited their service options, reduced the number of service providers and has on occasion forced them to utilize expensive equipment systems that they might not otherwise require. Moreover, while some NASULGC members are large universities located within urban areas, others are small colleges located in rural areas. For these rural member colleges, the local telephone company is often the only potential source of sophisticated information services. By limiting the ability of the BOC's to provide high technology communication services to the university community, the restriction has to some degree handicapped those smaller institutions at a time when advanced telecommunications and technologically-based research is crucial to the competitiveness of this nation's economy. 9/

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[7] According to data published by AT&T in 1984, 73 percent of residential customers spent less than $10 a month on interexchange service, and 85 percent of business users spent less than $55.00 a month on long distance. Putting aside the impact of local rate increases, the shifting of a $2.00 a month access charge in return for a 20 percent decrease in rate would result in a net benefit only to those spending more than $10 a month for long distance service, or a small fraction of the residential user community. S. Simon, After Divestiture: What The AT&T Settlement Means For Business and Residential Telephone Service, at 54 (Knowledge Industry, 1985).

[8] The exception is the increased competition and choice in for home telephone equipment. Clearly, there has been an increase in the numbers of low cost, feature-filled products for the home.

Thus, while the past three years may have produced benefits for some users of information and telecommunication services, in the form of new services and lower costs, the local-exchange citizen user has experienced mainly higher costs, with relatively few new services or options. This Court's restriction

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9/ *Cf.*, H. Geller, "Telecommunications Policy Today: Against Technology" (Issues in Science and Technology, Vol. II, No. 2, 1986) at 30-37.

prohibiting the BOCs from offering information services served as a major cause of this situation. While the Court's intention clearly has been to promote competition, the restriction has had the unintended result of narrowing the scope and diversity of information services and sources available to most Americans. For this reason, the Joint Commenters believe this Court should lift the restriction on the BOCs' ability to offer information services, subject to prudent ratepayer protections outlined in Section III.

C. Information Services Definitions

It is important to the Court's analysis of the issues surrounding the information services restriction to recognize that there are two distinct information service roles and products that are possible to be offered by the local telephone company. One is gateway information services -- those that involve a BOC establishing an information network to permit the offering of direct services by information providers. Huber Report at 6.14-6.17. Included among them might be protocol conversion, information storage and retrieval capacities, menu generation, packaging and marketing services. Id. at Table I S-10. These services enable the consumer to utilize other services more efficiently and less expensively. While competition exists for this gateway function, the case for BOC entry into these services seems to be the clearest of all. Many of these services are most efficiently offered if co-located or integrated into the network, and the service itself is akin to an access type function. Id.

The other type of information service entails the direct provision of information service products by the BOC. Information service products, in turn, can be subdivided into two types of products. One is those products that can be offered economically only if co-located or integrated into the network, as opposed to those other services which can be offered entirely apart from the network. Id. at 6.16. Class type services, voice mail, electronic mail are examples of these type of direct products that may need to be co-located to be viable. Id. at 6.16 n. 45. On the other hand, data base services, such as electronic publishing, can be accomplished through fully separated subsidiaries with little or no loss in efficiency. Id. at 7.1.

1. Gateway Services

A major section of the Huber Report's discussion of information services is devoted to discussing the role of the BOC as a gateway manager for the offering of information services which could be provided by any number of information service providers ("ISPs"). Id. at 6.10-6.17. As a gateway manager, the BOC could package the delivery of services, making them available to all consumers often without the need to purchase any special equipment.

Some of the most important "democratizing" services fall within the category of gateway services. A "smart" network enables the transfer of intelligence away from customer premises equipment into the network itself. While it is always possible to access networks through the personal computer, a "smart" network would permit the substitution of a "dumb" terminal for the "dumb" network. Today, in order to engage in electronic communications, it is necessary for the consumer to own the equivalent of a personal computer and the software necessary to communicate with other computers. If the software function is included in the network, however, the terminal used for the very same purpose can be many times less expensive and much simpler to operate.

Further, the existence of major differences in language and protocols between hardware, software and services can be eliminated through a smart network. A consumer would not require a modem or special cards or software to be able to talk with any other terminal over the network. And those with personal computers would also be able to communicate over the network directly with every other personal computer owner. 10/ Indeed, the day would come where every household could and should have an electronic telephone number as well as a voice number. With this capability, even if the homeowner decided not have his or her own terminal, the home would nevertheless be accessible for electronic meter reading, and would have access to an array of health monitoring, burglar alarm and similar services.

10/ See, e.g., Ouchi, "Theory PC" (PC World, Sept., 1985) at 106-108.

What we envision is the creation of a parallel "plain old data service" ("PODS"), coincident with POTS. The existence of this PODS would be of enormous economic, social and political significance. It would create the possibility that all consumers, rich or poor, young or old, could, if they wanted, have access to an array of information age services at this point available only to those who can afford the investment in expensive equipment. [11]

As the Huber Report and the Justice Report have pointed out, there are two examples which demonstrate the appropriateness of integration of specific gateway functions into the network and the access value of doing so to the public. The first is the use of the PBX. Id. at 6.41-6.42; Justice Report at 106-107, 116. Many of the services that have been listed in the Huber Report and which the Joint Commenters here consider important are already available to those users which are large enough and whose financial resources are adequate to purchase a PBX. The second is the French gateway system known as Minitel. See, e.g., Huber Report at Table IS-20, 6.45.

The PBX is relevant both as an example of gateway functions

11/ Moreover, plain old data service would switch demand from the voice switched network to the data network. Since data demand is growing at approximately four times voice demand, this will result in a more efficient network and a potentially more equitable distribution of costs. See, e.g., Petition for Declatory Judgement or Waiver, In the Matter of: Petition for a Declatory Judgement, or a Waiver of The Provisions of Section 64.702 of the Commission's Rules and Regulations to Enable Petitioners to Offer Protocol Conversions. NYNEX Corp., April 27, 1984.

and, as will be discussed below, for the offering of integrated services themselves. PBX's contain the capacity to offer services that are not possible in traditional equipment nor over the networks. Ultimately, PBX and Centrex-type services are gateways to a vast array of other services, which could also be offered ubiquitously to the entire network if the same capabilities could be offered by the BOCs.

The French Minitel service is a prime example of the benefits of establishing a local exchange gateway manager. In our view, the important points about this service are:

- Access to the system is simple and relatively inexpensive.
- Consumer demand for the system is driven by uses considered necessary and useful.
- The system has opened access by the public to thousands of small data base providers on an equal basis with large data bases suppliers.

Whole new markets are thus opened to the smallest data base provider, who otherwise might not be able to compete in the market. Obviously, such a result increases the number of information voices available to the public. Some of the Joint Commenters, particularly the National Association of State Universities and Land Grant Colleges, the National Consumers League, the National Indian Youth Council and the Public Interest Computer Association, are also potential suppliers of information services that would benefit directly from the offering of such a system.

Other gateway services of potential significance to the Joint Commenters are public announcement services. See, e.g., Huber Report at 8.4. Today, these services are both scarce and expensive. They are scarce because the available "976" numbers in many large cities, such as New York City, are already taken. They are expensive because they require investment in the CPE necessary to offer the services. If offered through the network, however, groups such as NASULGC, PICA and the church organizations would be more likely to be able to offer such services. Again, the information services restriction has operated as a restraint on the diversity of information sources for the public.

2. Information Products

Apart from prohibiting those information services that would provide for technologically superior gateways, the restriction also prevents the offering of specific information products through the network. For purposes of analysis, we have divided these into two categories, those products which are most economic if offered through integration or co-location, and those products that seem to be independent of location. [12]

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[12] For purposes of this analysis, we have relied on the Huber Report's classifications of which services are best offered through integration, and which can be offered independently. See, e.g., Huber Report at 6.40-6.46.

a. Integrated Offerings

Many of the services that are now available only to PBX users could be offered to the public through the local network. As pointed out in the Justice Report and the Huber Report, the fact that the PBX manufacturers and marketers have chosen to integrate the features is itself strong evidence that it is also appropriate for the BOCs. Justice Report at 114-115; Huber Report at 6.46-6.47.

The most noted and oft-cited example of services that are available to the large users but not to individual, citizen users are voice and electronic mail. The storage and retrieval function necessary for the offering of these services are also gateway functions, presumably also available to others from BOCs. 13/ But the services themselves could be offered by a BOC through its own equipment (and that of others) either co-located with or integrated into the switch.

Universal voice and electronic mail services offered on a per-use basis are in the public interest; the potential value of these services to consumers on an inexpensive, per-use basis is extensive. Significantly, these services, particularly voice mail, will be relatively easy and uncomplicated to use, a factor of importance to handicapped and the elderly who might find more

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13/ It is unclear to Commenters whether certain basic storage and retrieval functions would or should be classified as enhanced information services. To the extent that such services could be offered on an equal access basis to other ISPs, they take on the character of a form of exchange access. See Huber Report at 6.16.

complicated CPE a barrier to utilizing these services.

Other such services which would be valuable for citizen users include "CLASS Service" with call blocking, call tracing, distinctive ring, call transfer, self-directed call waiting and many more such services as detailed in the Huber Report. See Huber Report at Vol. II. Joint Commenters themselves are currently deprived of access to these and similar services which would enable them better to serve their constituents. In addition, their constituents could also be served by access to these services.

b. Nonintegrated Offerings

Direct offering of some information products by the BOCs would not necessarily require co-location with the switch. Yet there are economies that might be realized by allowing the BOCs to offer these services on an integrated basis. For example, the BOCs have operators offering directory assistance, and others who provide intra-LATA operator services. These same personnel could be used to provide a variety of different services, on a per-use basis, that are of special value to many rural, low-income, elderly or handicapped users, and their families. For example:

* An operator could call to remind a consumer of any number of things, such as medical appointments, time to take medicine, etc.
* A family could arrange to have an operator call an elderly parent at regular intervals to assure the parent's well-being.

- Small businesses could be offered a "dispatching" type of service through the BOC, when their budgets do not justify permanent dispatching staff.

Other services, such as electronic publishing, do not need to be co-located. And other than directories, the BOCs seem to have no special access or ability in the data base businesses, and would have to create new information. A BOC might decide to enter the electronic publishing business in competition with the many data base services now available, either the Source, Dialog and similar companies. As pointed out in the Justice Report and the Huber Report, should a BOC undertake to enter such a venture, it would be a virtual new entrant, with no special access or superior knowledge that would enable it to out-perform or out-price competitors. Justice Report at 112; Huber Report at Chapter 7

III. Ratepayer Protection

Although we believe strongly that the MFJ restriction regarding information services should be lifted, we also believe that safeguards are necessary in order to: (1) protect telephone ratepayers from subsidizing the provision of information services by the BOCs and (2) prevent discrimination by BOCs against non-BOC ISPs to preserve an open, competitive environment for the provision of information services.

Such safeguards are necessary because, as recognized by DOJ, the BOCs will continue to have the means to engage in both cross-subsidy and discriminatory access by virtue of their control over the basic local network, and they will have the incentive to engage in those practices in the event they are allowed to enter the competitive market for the provision of information services. It is therefore essential that appropriate safeguards be in place to prevent the BOCs from engaging in those practices.

A. The Bottleneck Issue and the Need For Non-Discriminatory Access

Permitting the BOCs to enter the market for the provision of information services carries with it the risk that the BOCs' monopoly control of local network facilities will be used to discriminate against competing ISPs. The search for various mechanisms to minimize this risk has occupied a central place in regulatory and judicial proceedings concerning the telecommunications industry over the past several years. Under its so-called Computer II framework, the FCC's solution for preventing the BOCs from discriminating against competing providers of enhanced services (a category of unregulated services that includes information services) was to require a structural separation in the form of a fully separate corporate subsidiary. 14/ In the face of evidence that the structural

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14/ Second Computer Inquiry, Final Decision, 77 FCC 2nd 384, modified on reconsideration, 84 F.C.C.2d 50 (1980), [hereinafter cited as Second Computer Inquiry Reconsideration], further modified on recon., 88 F.C.C.2d 512 (1981), aff'd sub nom. Computer & Communications Indus. Ass's v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, (continued...)

separation requirement of Computer II actually had the effect of inhibiting the introduction of new and innovative services to the public, the FCC recently adopted a new framework involving "comparably efficient interconnection" ("CEI") and "open network architecture" ("ONA") in its Computer III proceeding. 15/

We believe that the CEI and ONA requirements, if they are adopted as proposed by the FCC, will go a long way toward ensuring against discriminatory treatment of competing ISPs by the BOCs. Moreover, apart from the substantive aspects of CEI and ONA, we believe that the procedures adopted by the FCC for implementing them will ensure that users, consumers, competitors and other interested parties will have an adequate opportunity to participate actively, if they wish, in the process of shaping the BOCs' CEI and ONA plans with respect to specific services.

The CEI requirement of Computer III means that if a BOC wishes to offer an enhanced service, it must first have in place an approved plan for offering to all others interconnection opportunities that are comparable to the interconnection afforded for its own enhanced service. The CEI requirements (which basically are "equal access" requirements) contemplate that, for each specific enhanced service that a BOC wishes to offer free of the structural separation requirement of Computer II, a CEI Plan

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14/(...continued)
461 U.S.C 938 (1983), aff'd on second further recon., FCC 84-190 (released May 4, 1984).

15/ Third Computer Inquiry, Final Decision, 104 FCC 2d 958 (1986) (hereinafter "Computer III").

must be filed, reviewed, and approved by the FCC prior to the offering of any particular enhanced service. Computer III at ¶201, 104 FCC 2d at 1059. Furthermore, the CEI plans filed by the BOCs must conform to certain pre-established parameters: they must contain specific provisions for the availability of standardized hardware and software interfaces; basic services and basic service functions underlying the enhanced service must be unbundled from other basic service offerings; all technical characteristics of the basic services available to enhanced service competitors must be equal to those of the basic services utilized by the BOC for its own enhanced services; the BOC must provide equal availability of installation, maintenance and repair for underlying basic services; the same kind of end-user access afforded for the BOCs' own enhanced offerings must be available to other providers; and CEI must be available to all potential enhanced service providers, large and small. Computer III, 104 FCC 2d at 1035-1042, ¶154-166.

CEI is but a precursor to a much broader concept; the FCC's Computer III decision adopted the requirement of service-specific CEI Plans as an interim measure, pending the adoption of comprehensive ONA Plans by the BOCs. The ultimate achievement of an ONA standard (which incorporates CEI) would enable the BOCs to offer enhanced services on an unseparated basis without the need for the filing and approval of service-specific CEI plans. At the heart of ONA is a network design and tariff structure which unbundles the underlying "building blocks" of basic service and which makes those basic service elements available to the public (including enhanced service competitors) on a non-discriminatory basis. The BOCs are required to file ONA plans by February 1, 1988, and Commission approval of each plan is a precondition to the removal of the structural separation requirement for the provision of enhanced services. Computer III at ¶210-222, 104 FCC 2d 1059-68.

The BOC's role under CEI/ONA is similar in many respects to their role as the managers of equal access for interexchange services. The CEI and ONA requirements are, in essence, equal access requirements for the information (or enhanced) services market, analogous to equal access in the long distance market. The accomplishment of equal access in the long distance market has been tried, tested and, by now, is largely and successfully implemented. The same result can be achieved in the context of the information services market.

We believe that the CEI and ONA procedures, even though not fully implemented as yet, will constitute appropriate regulatory safeguards to protect against discriminatory use of the local network as a bottleneck facility. Therefore, Commenters urge the Court to adopt the requirement of CEI/ONA as a condition of lifting the information service restriction. As with equal access, CEI/ONA should be handled appropriately by the FCC. Under such a scheme, the Court would be available to the parties, as it has been during equal access implementation, to resolve specific complaints or problems.

B. Protections Against Cross-Subsidization

One of the principal advantages of allowing the BOCs to enter the information services marketplace is that consumers will be able to benefit from the efficiency inherent in the BOCs' ability to integrate information services as part of their networks. Although such integration will undoubtedly bring benefits to consumers of information services in the form of new and improved services and lower prices, it also brings with it the potential danger of cross-subsidy of nonregulated information services by revenues from regulated communication services. The potential harm in this regard not only would affect the ratepayers for regulated communication services who might end up paying more for basic services than they otherwise would if the cross-subsidy did not exist, it also has the potential of driving from the marketplace competitive providers of information services. In order to protect ratepayers of regulated communications services as well as to ensure a fair competitive environment in the marketplace for nonregulated information services, it is important to guard against the possibility of cross-subsidy.

One way for harmful cross-subsidy to occur in the information services market is through discriminatory access practices whereby a BOC charges competitive ISPs more for access to the network than it charges itself. We believe that the possibility of such unequal treatment is sufficiently mitigated by the CEI (and, eventually, ONA) that will be required by the FCC prior to any BOC being allowed to provide information services. The fact that all access services will be tariffed and that all intracorporate transfer pricing must be in accordance with published tariff rates should suffice to resolve this aspect of the potential cross-subsidy problem.

Another manner in which cross-subsidy can occur is through the misallocation of common costs. In this regard, the FCC has recently adopted its Report and Order in CC Docket No. 86-111 pertaining to new accounting and joint cost allocation approaches for nonregulated activities of telephone carriers (FCC 86-564, released February 6, 1987, hereinafter "Joint Cost Order"). In that order, the Commission required carriers to separate their regulated costs from their nonregulated costs using a fully-distributed methodology and cost-attribution principles that incorporate direct assignment and cost-causation as the fundamental standards for allocation. The BOCs must file detailed cost allocation manuals no later than September 1, 1987, setting forth the manner in which the new cost allocations standards will be implemented. The manuals will be subject to Commission approval before the BOCs will be permitted to implement the new cost allocation standards, and, in order to ensure compliance, each BOC will be required to submit an annual audit by an independent accounting firm attesting that the carrier's cost allocation manual has been implemented properly and that the carrier's cost allocations are accurate. Joint Cost

Order at ¶250-259. Most importantly, the Commission has required, as part of its Computer III framework, that an approved cost allocation system consistent with the principles of the Joint Cost Order, be in place before any BOC may provide any enhanced services on an integrated basis (i.e., without doing so through a fully separate subsidiary).

We believe that the new system of joint cost allocation standards that has been adopted by the FCC, the implementation of which is, like CEI and ONA, a precondition of the provision of any nonregulated or enhanced services by a BOC, should be sufficient to guard against the dangers of cross-subsidy between the provision of regulated and nonregulated services.

C. Safeguarding the Local Exchange Customer

Not surprisingly, there are similarities between what the FCC has proposed with respect to CEI/ONA and what this Court mandated in 1982 when it adopted the MFJ. CEI and ONA have, as their focal point, a requirement that the BOCs offer access to their local exchange facilities for all information service providers on an unbundled, nondiscriminatory basis pursuant to cost-based tariffs. This requirement is analogous to the one adopted five years ago by this Court, i.e., that the BOCs' access tariffs "provide unbundled schedules of charges for exchange access," and that such tariffs be "cost justified." U.S. v. American Tel. and Tel.Co., 552 F. Supp. 131, 233 (Appendix B (B)). In the same way that access charges for long distance interconnection contribute to the non-traffic sensitive (NTS) costs of the local loop, so likewise should information services interconnection make a similar contribution.

The FCC has specifically acknowledged that CEI is a form of interconnection that makes basic network facilities and services available to the public, and as such, is a basic service itself and subject to regulation at both the state and federal levels. Computer III, 104 F.C.C.2d at 1039. In this regard, CEI (as well as ONA, which will follow it) constitutes a means of facilitating utilization of the local exchange. Under the new joint cost allocation rules recently adopted by the Commission, the cost of CEI must include a portion of the NTS costs attributable to the local subscriber loop. It is proper and beneficial for all ISPs (including the BOCs themselves) to contribute to the costs of the local loop. From the consumers' point of view, the fact that information service providers will contribute to NTS costs should help provide a downward pressure on rates for basic telephone service.

To a significant extent, the BOCs already provide a form of equal access to information service providers. At present, anyone can offer services through the equivalent of a line side connection. What is possible, but which has not yet been allowed to develop, is the creation of an equivalent of the "trunk side" connection, offering a bundle of basic services to ISPs, including BOC affiliates, for use in delivering information services to the local exchange customer. Such an offering, which has been referred to as a feature node, [16] is like a "trunk side" connection. It is at these "feature node" type of connections that the BOCs will be able to charge the ISPs, in much the same manner that they now charge interexchange carriers.

Joint Commenters suggest that this structure offers significant consumer benefits. As noted, the ONA connection is tariffed and priced on a fully distributed basis. As a result, there will be additional contributions to non-traffic sensitive costs of the network. Consequently, the more services and the higher the usage, the lower the unit costs should be not only for each information service provider, but in effect for the residential user as well. Currently, external contribution to the NTS cost of the local exchange is limited to IXC's, and their total contribution has been frozen at 25 % of NTS costs. With ONA in place, however, there will be the potential for truly new contribution. [17]

D. Procedures for Monitoring the Effectiveness of the Safeguards

Because lifting the MFJ restriction on the provision of information services by the BOCs depends on compliance with certain preconditions, namely, the adoption and effective implementation of appropriate CEI or ONA standards and the implementation of joint cost allocation mechanisms, it is necessary that a proper forum and procedures be available for monitoring compliance.

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[16] See Huber Report at 6.23, 6.24, where he describes at length the Ameritech proposed "Intelligent Network/2 Architecture."

[17] In fact, there can be new contribution to NTS costs even before ONA is implemented, to the extent that new services are offered through line side connections. See, e.g., In the Matter of the Bell Atlantic Telephone Companies Offer of Comparably Efficient Interconnection to Enhanced Services (filed March 6, 1987).

We have expressed major reservations about the potential for harm to consumers and competition if the CEI/ONA and cost accounting systems are not properly implemented. Therefore, Joint Commenters suggest to the Court that it direct the DOJ to conduct an annual review of the implementation of information services through the CEI/ONA process and file an information report with this Court. That report should be made available for public comment. Based on the annual filing, the Court would be in position to modify or stop any of the ONA/CEI activities it deemed inconsistent with the underlying MFJ.

Joint Commenters note, too, that there will be ample opportunity for public participation before the FCC to ensure that the views of consumers will be taken into account as the CEI/ONA plans are developed. The FCC, for example, has specifically provided with respect to both CEI and ONA plans that there will be opportunity for public comment prior to approval of such plans by the Commission. Computer III, 104 FCC 2d at 1055, 1067. Similarly, the Commission has stated that public comment will be invited on the carriers' proposed cost manuals, and that such comments will be considered before any interim or final approval of such manuals is granted. Report and Order in Docket

86-111 at ¶230. Furthermore, with respect to CEI and ONA, the Commission has indicated that its "complaint process is available to carriers' enhanced service competitors and end users as a continuing check on potential anti-competitive activities." Computer III, 104 FCC 2d at 1068.

And finally, should the Court decide to implement removal of the information services restriction, the MFJ and the Court's order in this proceeding, will provide added protection. The DOJ has recognized that Section II (B) of the MFJ (552 F. Supp. at 227) prohibits a BOC from favoring its own information services or its own information service customers over those of competing information service providers, thus assuring that this Court will have continuing jurisdiction with respect to the provision of information services. 18/ Combined with an annual review of the information services implementation, these safeguards are more than adequate to assure an implementation process that will be effective to minimize the risks of cross-subsidization and anti-competitive behavior.

18/ Justice Report at n. 300.

IV. Conclusion

The Joint Commenters believe that the Court faces an enormously important balancing task: it must weigh the actual costs of not lifting the information service restriction--the greatest of which is the continued loss of service options to the public--against the possible risks of anti-competitive activity and cross-subsidization. Joint Commenters believe that their interests, and the interests of their members and their publics are best served by removal of the information service restriction by an order which: (1) requires the implementation of CEI/ONA, as was done with equal access in the MFJ; (2) requires that the tariffed CEI and ONA offerings by the BOCs contribute to the non-traffic sensitive costs of the local loop; and (3) maintains the Court's jurisdiction over information services by requiring an annual report from the Department of Justice, and by including information services on the agenda for the Court's next triennial review of the MFJ.

Joint Commenters believe that the interests of all concerned--the information provider, the large institutional users, the telephone company and the citizen user--are all fostered by rapid movement toward a more open and competitive information services marketplace. This cannot happen, however, until such time as the BOCs are allowed to enter into that line-of-business, subject to appropriate safeguards as outlined herein.

Respectfully submitted,

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Dated: March 13, 1987

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

United States of America, Plaintiff, v. Western Electric Company, et. al., Defendants.	)	Civil Action No. 82-0192

Joint Reply Comments
of
National Consumers League
Black Citizens for a Fair Media
and the Council of Churches of New York City
National Association of State Universities
and Land Grant Colleges
Native American Public Broadcasting Consortium
and the National Indian Youth Council
Office of Communications of the Church Federation
of Greater Chicago
Consumer Interest Research Institute
Public Interest Computer Association
and
National Association for Better Broadcasting

Joint Commenters submitted comments in support of lifting the information services restriction, subject to conditions that would minimize the risk of anti-competitive results and which would promote universal service.

Upon a review of the record now before the Court, Joint Commenters believe they have outlined a reasonable and responsible middle-ground proposal for lifting the information services restriction that balances the diverse interests of the various stakeholders, the public in general and anti-trust policy goals. Consequently, Joint Commenters will limit these reply comments to several observations concerning the record on the information services restriction and to a reiteration of the opportunity the Joint Commenters see for assuring the contribution of information services revenues to the NTS costs of the local network.

A. THERE IS BROAD SUPPORT FOR LIFTING THE INFORMATION SERVICES RESTRICTION

There is broad support in the record for lifting the information services restriction. It is the only point on which all of the principal parties -- AT&T, the seven regional companies and the Department of Justice -- agree. Of course, the record reflects support for and opposition to lifting each of three lines of business restrictions. However, it appears to Joint Commenters that the weight of the comments strongly supports lifting to some degree of the information services restriction.

Joint Commenters distinguished in their filing among three types of information services -- "gateway" type services, "product" type services and electronic publishing. It is significant to Joint Commenters that the American Newspaper Publishers Association ("ANPA"), historically the most ardent opponent of competitive entry into the information services industry, suggested similar distinctions. 1/ Indeed, ANPA urges

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1/ Comments of the American Newspaper Publishers Association, at 61 - 67.

the Court to lift, via a "clarification," what it terms "low-level" network functions, which are essentially those which Joint Commenters define as "gateway" functions. Further, ANPA urges a waiver process for "mid-level" services, essentially those services Joint Commenters classified as "products." It is only on the publishing functions that ANPA supports a continued total ban, while Joint Commenters suggest that a separate subsidiary requirement might be more suitable under the circumstances.

In fact, only a few commenters argue against any form of relaxation of the information services restriction. Primarily, those arguing against any change are competitors whose main interest appears to be protecting what amounts to competitive advantage granted by this Court. 2/ Joint Commenters, in this regard, associate themselves with the position taken in the joint comments of Henry Geller, Harry M. Shooshan, Dr. Charles Jackson, Dr. Everett Parker, Dr. Jeffery Rohlfs and Donna Lampert. They suggest that many of the competitors are actually "phantom" in that they want to keep BOCs out of markets that they prefer also not to enter at this time. 3/ By keeping the BOCs out of the

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2/ See, e.g., Opposition of Compuserve Incorporated, Opposition of Electronic Industries Association Information and Telecommunications Technologies Group, and Intervenor Badger Meter, Inc.'s Memorandum in Opposition to the Department of Justice's Proposals Relating to the Modified Final Judgement.

3/ Comments at p. 6 and n. 10. See also, Comments of The Videotex Industry Association on the Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating (continued...)

information services market, this Court has condoned what amounts to stockpiling of the residential and small business end of the market. Joint Commenters believe the potential entry of BOCs into the information services markets most likely will stimulate competition and new entry in the heretofore underserved residential and small business markets. Rather than drive competitors out, BOC entry will cause those potential competitors who to date have found it safe to delay entry into consumer markets to realize that they must enter earlier to be competitive.

In summary, the record shows that, in addition to the consumer and minority interests represented by the Joint Commenters, lifting of the information services restrictions to some degree is supported by competitors [4/], regulators, [5/] labor, [6/] as well as AT&T, DOJ, FCC and the seven regional companies.

3/ (...continued)
Companies, at p. 9, n. 14, citing a report of Knight-Ridder officials claiming that the company entered into a videotex venture in order to protect itself in the event that videotex became a threat to either newspaper advertising or readership, but concluded that videotex would not likely be such a threat in the foreseeable future.

[4/] See, e.g., Comments of the Videotex Industry Association on the Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies, Comments of the Computer & Communications Industry Association.

[5/] See, e.g., Comments of the People of the State of California and the Public Utilities Commission of the State of California.

[6/] Comments of the Communications Workers of America.

B. THE UNIVERSAL SERVICE GOAL OF THE COMMUNICATIONS ACT INCLUDES ACCESS TO AFFORDABLE VOICE AND INFORMATION SERVICES

Universal service and BOC entry into the information services line of business are complimentary, not mutually exclusive. Indeed, Joint Commenters reiterate their firm commitment to the goal of universal telecommunications service to all consumers at reasonable and affordable rates. Joint Commenters, however, believe that properly interpreted, the national policy embodied in the 1934 Communications Act means, in 1987, universal and affordable access to the full range of electronic telecommunications technologies.

To limit the universal service goal of this country to voice service today would be the equivalent, at an earlier era, of limiting the general public to telegraphy, while offering "enhanced" voice services only to big business users. The Communications Act of 1934 must be interpreted in light of present day technology. The public interest in ubiquitous advanced telecommunications services is, in our view, at least as great, if not more so, than was the public interest goal in 1934 of achieving ubiquity of the original voice network.

Joint Commenters believe that the goal of universal service at affordable rates for all consumers of both voice and data services is achievable, provided the information services restriction, with the protections outlined by the Joint Commenters, is lifted.

Of all the commenters, ANPA argues most strongly that the MFJ restrictions are not causing unexpected costs to consumers because of lost efficiencies and the unavailability of services. [7/] A close reading of ANPA's filing reveals that ANPA acknowledges that the services that are available today in the United States, "aim primarily at young professionals with some computer expertise." [8/] Further, ANPA points out that "services targeting a broader cross-section have experienced less market success." [9/] ANPA concludes, as do we, "consumer-oriented electronic publishing remains largely in the future." [10/] We do not agree, however, that this result is somehow inevitably dictated by the nature of either the technology or the market place. Indeed, it is caused to a significant degree, we believe, by the MFJ's information services restriction on the BOCs.

Clearly, the price of entry to the information age today is at the least the cost of a personal computer, a modem, software and the education or aptitude required to operate them. [11/] As pointed out by the Joint Commenters in their original filing,

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[7/] ANPA Comments at 16. Joint Commenters believe that ANPA's arguments are rebutted persuasively by the filing of the Videotex Industry Association. Comments of the Videotex Industries Association at p. 11.

[8/] Id. at p. 22.

[9/] Id.

[10/] Id.

[11/] See Comments of the Videotex Industries Association at p. 11.

this is so because most of the intelligence has been forced out of the network into the terminal. Imagine if the original voice network had been designed to require every consumer to purchase a $1,000 home telephone set that generally required between fifteen and thirty hours of training to use effectively. Would it have been fair under that scenario to argue that the slow adaptation of the residential consumer to voice telephony was the result of natural market forces?

Our point is that the division between access to voice and data services is simply unsupportable in the information age. Joint Commenters are very sensitive to the complexity of the current industry and market, and are very concerned that the process of lifting the information services restriction contain protections against anti-competitive conduct and cross-subsidization. That is why Joint Commenters urge the Court to include in its order the requirement that the BOCs offer equal access and comply with accounting safeguards.

C. USING INFORMATION SERVICES REVENUES TO CONTRIBUTE TO PAYING THE COST OF THE NETWORK.

As stated in our comments, we believe that increased utilization of the existing telephone network for new and different purposes is clearly in the public interest. Such utilization will help defray some of the existing costs of the network for consumers of basic telephone service by helping to spread those costs among a new and larger group of users.

With regard to the latter point, we expressed the view that arrangements for interconnection to the network for purposes of providing information services should include a contribution to the non-traffic sensitive (NTS) costs of the local loop in the same fashion that access charges for long distance interconnection make such a contribution. We believe this is an important and central point that merits elaboration.

At the present time, the totality of NTS plant commonly used for interstate and intrastate telephone use is allocated, based on the interstate/intrastate distinction, between the two jurisdictions according to a formula that seeks to approximate (eventually, at least) relative use (see 47 C.F.R. 67.124(d)(5)-(d)(7)). What we suggest is that, in like fashion, the NTS plant commonly used for traditional voice telephone service, on the one hand, and the new information services, on the other, be apportioned accordingly, i.e., based on the distinction of local exchange telephone services vs. information services. 12/ Such a usage-based apportionment would be consistent with the cost-causative principles of the FCC's new Joint Cost Order.

In our joint comments, we indicated the view that, using the joint cost allocation principles of the Joint Cost Order in combination with the Commission's CEI/ONA framework of Computer

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12/ The distinction is supportable based on information services that enter the local exchange through CEI/ONA interfaces. Of course, we do not suggest separate pricing for all data use of the existing network. Rather, data (information) services that are offered through the new interface points will be identifiable and measurable.

III, the cost of information services interconnection would include a portion of NTS costs attributable to the local subscriber loop. We hold that view based on our interpretation of the "basic service element" components of CEI and ONA, into which the BOCs would be required under the Computer III decision to separate and subdivide through unbundling the essential elements of basic service. Because an essential component of basic service includes, of course, access to the subscriber *via* the local loop, we would anticipate that an allocable share of the cost of the local loop would be included in the carriers' unbundled CEI or ONA offerings.

On reflection, we want to emphasize that the range of "basic service elements" which will comprise the CEI or ONA offerings is sufficiently undefined at this time as to raise a question whether an allocable portion of NTS costs would (as we believe should be the case) in fact be included as part of the unbundled CEI/ONA elements. That is why we urged this Court in our Joint Comments to require, as a condition to lifting the information services restriction, not only that the BOCs afford access to the network to others on the same terms and conditions that they afford access for their own information services, but also (and, in our view, as important) that the cost of such access for both BOC and non-BOC providers alike include a contribution toward NTS costs of the network. Indeed, even if we were totally confident that, under the joint cost allocation rules and the Computer III decision, the allocable costs of NTS would be included in the

CEI/ONA elements, we would want this Court to mandate such a result. [13/] In at least this fashion, expanded use of the network for new information services will help provide downward pressure on rates for basic telephone service. We note, too, that other commenters have argued that added revenues from information services could be used to keep local, voice rates down. [14/]

D. CONCLUSION

Joint Commenters reiterate their strong support for lifting the information services restriction, subject to the equal access, pricing and monitoring conditions specified in their

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[13/] Joint Commenters acknowledge that there is a great deal of uncertainty today over where jurisdiction over pricing of particular information services will lie. With the uncertain authority of the FCC to preempt State regulation, it is entirely possible that States will have a major influence on how exchange access for information services will be priced. With proper Court guidance, however, local exchange access through CEI/ONA could be priced on the equivalent of a "carrier common line" basis. We appreciate the concern expressed by CFA, et. al., in their comments that prevailing FCC cost-causation theory could result in pricing information services exchange access on a marginal cost basis. We, too, oppose such a result and urge this Court to require NTS contribution. Ultimately, though, it is the federal and state regulatory processes, with Congressional oversight, that provides the appropriate forum to check the FCC's movement in this direction. We note that the information services exchange access as we propose it is more akin to "terminating" access than "originating" access, and thus much less susceptible to bypass. Even under the most recent FCC/Joint Board repricing decisions, there continues to be a terminating access CCL charge that contributes to NTS costs.

[14/] *See, e.g.,* Comments of the People of the State of California and the Public Utility Commission of the State of California.

Joint Comments. We believe the record amply supports Joint Commenters and provides this Court with a basis for proceeding along the lines outlined by Joint Commenters in their original submission to this Court.

Respectfully submitted,

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May 8, 1987

The Honorable Howard M. Metzenbaum
Chairman, Subcommittee on Antitrust,
Monopolies and Business Rights
Senate Committee on the Judiciary
140 Russell Senate Office Building
Washington, D.C. 20510

Dear Chairman Metzenbaum:

On behalf of the National Telephone Cooperative Association (NTCA), I would like to submit this letter for the record for the April 30, 1987 hearing entitled: "Modifications to the AT&T Decree." NTCA is a national trade association which represents more than 450 small, independent cooperative and commercial telephone companies throughout rural America.

Although not a party to the antitrust proceedings, NTCA was active in the original Tunney Act proceedings in United States v. Western Electric, C.A. No. 82-0192, for the purpose of advising the Court as to the potential impact of the consent decree on the nation's 1128 small independent telephone systems and their estimated 5 million subscribers.

The Modification of Final Judgment (MFJ) governing the AT&T divestiture limits the activities of the divested Bell Operating Companies (BOCs). The restrictions imposed under the MFJ were intended to promote a competitive telephone industry while preserving affordable local telephone rates. It has been proposed that some of the restrictions on BOC business ventures be lifted. Senator Gore has introduced legislation, S.209, which would lift the prohibitions against BOC involvement in telephone equipment manufacturing and information services.

Also, as you know, a court review of the MFJ is currently underway. The U.S. Department of Justice (DOJ) recommends that the BOCs be allowed to: (1) manufacture telephone equipment; (2) provide information services; and, (3) seek waivers from the Court to provide inter-LATA service at such time as state restrictions on entry into local exchange service are removed. NTCA is opposed to permitting the BOCs to provide long-distance service under individual pricing schedules because it will increase pressure on AT&T to deaverage toll rates. AT&T provides long-distance service to virtually all rural areas. Deaveraged rates could result in substantially higher rural rates because toll facilities are more costly to maintain, and the subscriber base is small and dispersed.

NTCA also opposes the DOJ recommendation that Bell companies be allowed to provide long distance service after state laws protecting local exchange service areas are removed. Introducing competition into local franchise areas would result in "cream skimming" of a local telco's most profitable customers. Rates would increase for the remaining high cost subscribers because they would have to shoulder more of the burden of the fixed costs for telephone service.

NTCA also is concerned about the conditions under which the prohibition against equipment manufacturing is removed. We do not want a repeat of the captive monopoly supplier situation that existed when AT&T manufactured telephone equipment exclusively for the Bell system. Prior to divestiture, independent telephone companies were excluded from purchasing equipment.

NTCA urges Congress and the Court to ensure that universal telephone service is not jeopardized in the course of revising the divestiture decree. Specifically, NTCA opposes BOCs entry into inter-LATA toll service. We also oppose the DOJ proposal that the Court establish incentives to eliminate state laws protecting local service franchise areas so that the BOCs can provide interexchange services. NTCA does not object to the removal of equipment manufacturing restrictions so long as controls are established to ensure adequate equipment is readily available to rural telcos at reasonable prices.

We commend you for holding this hearing, but are concerned that small company issues were not addressed. Therefore, in the event that you have another hearing, NTCA would appreciate the opportunity to present testimony further documenting our position on these important questions.

Sincerely,

Michael E. Brunner
Executive Vice President

STATEMENT OF
O. GENE GABBARD

CHAIRMAN, MANAGING COMMITTEE
NATIONAL TELECOMMUNICATIONS NETWORK

The National Telecommunications Network welcomes this Committee's timely inquiry into the state of competitiveness within the telecommunications industry. This Committee, more than any other, understands the crucial role played by antitrust laws and remedies in promoting competition and deterring abuse of monopoly power. You are well situated to help Congress assess the continuing importance of the antitrust principles embodied in the AT&T Consent Decree, while the U.S. District Court undertakes its triennial review of the Modification of Final Judgment.

NTN is a joint venture of regional fiber optic telecommunications companies, so we therefore are primarily concerned with the provisions of the Decree which prohibit the BOCs from providing interLATA, or long distance, services. These provisions are the cornerstone of the Consent Decree. They were agreed to by the parties and decreed by the Court as a fundamental element of the settlement of a landmark antitrust case. They must not be eliminated or eroded in any respect until the telecommunications industry is truly competitive.

As an initial matter, NTN is pleased that, in light of the Comments submitted to the Court in connection with the ongoing review of the MFJ, the Justice Department has reversed its initial position and is now calling for retention of the interLATA service restriction in full. Similarly we are gratified that Judge Greene has underscored the continuing importance of the Decree's restrictions with his emphatic reminder to the Justice Department of its responsibilities to investigate alleged violations and to enforce the Decree generally.

We hope this Committee will follow suit and likewise encourage the Department to ensure that the letter and spirit of the Decree are carried out. It is striking that the Justice

Department seems to have undertaken no "compliance audits" under the Decree provisions that expressly permit the Department to monitor BOC operations. We note, for example, that a recent FCC staff report found that the BOCs are deploying massive amounts of interLATA transmission capacity -- all at ratepayer expense. Indeed, they have installed several times the total long distance capacity AT&T had at divestiture even though: 1) they are limited by the Decree to intraLATA service, and 2) at divestiture they retained the facilities necessary to continue to provide such service. Yet the Department apparently has done nothing to follow up on the FCC staff's findings.

Furthermore, this Committee should make clear that the Justice Department must not encourage or support waivers of the interLATA prohibition. We are disturbed by lingering suggestions from the Department that such waivers might be supported, creating a back-door avenue for the BOCs to gut the Decree. Judge Greene has correctly recognized that "even to leave open the possibility" of BOC entry into the interLATA market would encourage the BOCs "to spend ratepayer funds for long-distance network construction" and "to position themselves for successful entry by discriminating against other carriers." The BOCs are doing just that today.

As I will explain, NTN has asked the court to impose a six-year moratorium on any waiver or relaxation of this element of the Decree. But this Committee also must investigate the Justice Department's troubling comments regarding waivers, and help make clear to the BOCs that they should not be spending ratepayer funds in in anticipation of premature waiver of the interLATA restriction.

The NTN Network

Allow me to tell you briefly what NTN has accomplished in response to the promises of competitive opportunity made in the Decree. Among the developing long distance telephone competitors, we believe that NTN is unique in character and promise. We are a joint venture of seven companies, each of which has recently constructed a regional fiber optic network. Through NTN, the regional networks have been interconnected to form the first national, wholly digital fiber optic network. The seven members of NTN are: Consolidated Network, Inc., Matoon, Illinois; LDX Group, Inc., St. Louis, Missouri; LiTel Telecommunications Corporation, Worthington, Ohio; Microtel, (-SOUTH-)a Raton, Florida; SouthernNet, Inc., Atlanta, Georgia; Southland FiberNet, Inc., Pensacola, Florida; and Williams Telecommunications Company, Tulsa, Oklahoma.

As indicated by the map attached to my statement, the NTN network comprises more than 10,500 route miles extending throughout most of the United States. This network reflects a total investment of approximately $1 billion. The backbone network already enables NTN to serve more than 150 cities coast-to-coast. Additions planned for 1987 will extend direct network service to 80% of the metropolitan areas and over 90% of the population of the country.

The transmission capacity constructed by the NTN members is both a product of divestiture and vital to divestiture's success. A principal purpose of the Consent Decree, in the words of the Court, is "to effect a change-over from the AT&T de facto monopoly to a competitive interexchange market." NTN competes directly with AT&T in the private line market, and some members also provide switched services. But equally important, NTN provides bulk capacity to other carriers, most of whom formerly were dependent upon AT&T facilities to provide their services. Although a few larger carriers had some analog facilities in 1982, it was clear that if active interLATA competition was to develop, new carriers required an alternative to AT&T. NTN has supplied that choice by providing high quality digital circuits at a reasonable cost to a very large number of AT&T's competitors.

The Broad Consensus Opposing Relaxation of the InterLATA Restriction

As you know, the U.S. District Court currently is undertaking a review of the Consent Decree, in particular the continuing need for the Decree's line of business restrictions. The Court's assessment will be guided by the legal standard set forth in the Decree: whether there is any substantial possibility that a BOC could use its monopoly power to impede competition in the interLATA market. Pursuant to that standard, the Court has said, no change in the interLATA restriction should be permitted until such time as the Regional Holding Companies lose their "bottleneck" monopolies and there is substantial competition in local telecommunications service.

Thus a key question before the Court is whether the BOCs still maintain their bottleneck control over the local telephone network. The answer, as emphasized in the comments and filings that have been submitted, is a resounding "yes." From its own experience, NTN knows that the BOCs' bottleneck is still a basic fact of life, for in most instances NTN has no choice but to use BOC facilities to obtain local access to its customers. The Justice Department, its specially-appointed consultant Dr. Peter Huber, and the National Telecommunications and Information Administration have all confirmed that the BOCs still possess substantially the same bottleneck control that necessitated the interLATA restriction in the first place.

This view is shared by an overwhelming consensus of parties that have submitted comments to the Court. These include consumers and large business users, labor, independent telephone companies, state utility consumer advocates and public service commissions, as well as interLATA carriers and resellers. Each from its own perspective, these parties have reaffirmed the continuing competitive need for the interLATA service prohibition.

Anticompetitive Implications of the BOCs' Continuing Bottleneck Power

In spite of this consensus, the BOCs have asked the Court to gut the competitive safeguards provided by the interLATA restriction. But they have presented virtually no evidence to counter the conclusions reached by so many others. Instead the BOCs simply assert that their bottlenecks have eroded, or that regulation can prevent abuse of the bottleneck where it continues. But wishing does not make it so. The simple fact is that in the three short years since divestiture, no miracle has occurred to eliminate the BOCs' decades old monopoly. NTN will not burden this Committee with another historical analysis of the regulatory failings which permitted the Bell System to exploit its bottleneck, hence necessitating the restrictions of the AT&T Consent Decree. As the Committee is aware, most of the regulatory safeguards relied upon by the Justice Department in support of the removal of the manufacturing and information services restrictions are not yet defined, let alone tested.

The NTN members felt so strongly regarding the Justice Department's original proposals to lift aspects of the interLATA restriction because these proposals were so obviously premature. Thus we were gratified when the Department reversed itself and concluded that the interLATA service restriction should be retained in full. Even the suggestion of such imprudent changes by regulatory officials is damaging to competition. Proposals to relax the MFJ's restrictions upset reasonable business expectations, reduce customer and investor confidence in the ability of new carriers to survive, and encourage the BOCs to prepare to provide interLATA services themselves through improper cross-subsidization and discrimination.

The anticompetitive prospects of BOC entry are particularly vivid for carriers like NTN which depend largely upon special access, as opposed to switched access, to serve its customers. BOC special access is poorly regulated and subject to great abuse. We note, for example, that last week the FCC finally issued an order rejecting certain special access rates of several BOCs for high capacity and digital data services that were designed to earn "returns of 40% to 60%." The FCC concluded that these rates indicate that the BOCs "are not yet subject to marketplace contraints." Obviously not. But unfortunately many, many more excessive special access charges remain in effect today.

Special access discrimination also is a serious problem. A BOC competing in the interLATA market would have to do very little, very discretely, to injure the reputation of competitors like NTN. Our customers are individually identifiable to the BOC since we connect directly to our customer's premise -- and the BOC knows exactly by what facility that access is provided. If the BOC's access is installed late or service "fails," the customer has no back up. NTN loses good will and revenue, even if the problem is caused by the BOC. Thus, for example, if a western BOC were permitted to compete with NTN to sell private lines in the eastern United States, it would have an incentive to give NTN inferior access to points in its western region, in order to damage NTN's reputation in the industry for service reliability.

Still other opportunities for unfair competition would be created if the BOCs were permitted to offer interLATA service. InterLATA carriers seeking either switched or private line access to BOC facilities must provide competitively sensitive information about themselves and their customers to the local BOC. That information could in turn be exploited by the BOC to obtain customers for its out-of-region interLATA service. And prospects for a BOC to cross-subsidize its interLATA service are equally formidable. The inherent difficulties of preventing and detecting cross-subsidization -- and the costs imposed thereby on telephone ratepayers -- were a principal reason for divestiture. The FCC and the states have been unable to prevent such anticompetitive conduct in the past, and there is little reason to infer that they will be successful in doing so in the future.

The Need For an Express Moratorium on Waivers

NTN has asked the Court to state expressly that it will not consider proposals for waiver or revision of the interLATA restriction until the Justice Department files the 1993 triennial report. We have offered numerous grounds in support of this request. The BOCs are engaged in a massive, unauthorized effort to increase their interLATA transmission capacity through the installation of new fiber optic facilities. The cost of this construction is being borne by ratepayers, further increasing the BOCs' potential competitive advantages.

A six-year moratorium on interLATA waiver petitions would deter such improper investment. It would also eliminate unnecessary and burdensome litigation that drains valuable resources and energy from new competitors, the Court, and other parties. It would reduce the debilitating uncertainty in the market which drives up new companies' cost of capital and makes long-term service commitments much harder to obtain. And it would allow time for a record to develop concerning the effectiveness of new FCC regulatory safeguards that the BOCs claim are so important.

As the Committee is aware, Judge Greene has recently issued an order emphatically reminding the Justice Department of its obligations to investigate alleged BOC violations of the Decree and to enforce the Decree strictly. We urge you to take similar action, and to insist that the Department use its investigatory powers to probe improper BOC activities such as the fiber deployment and special access concerns discussed above. We also urge you to make clear that the Department should not encourage or support any waivers of the interLATA restriction in the forseeable future.

The BOCs Should Focus on Local Network Improvements

In addition, we urge the Committee to review carefully the progress of the BOCs in modernizing their local networks, to ensure that they keep pace with advancements in technology and society's ever-increasing demand for information. NTN and other carriers have now installed the long distance component of nationwide digital networks. This is a great step forward, but the full potential of these networks will be realized only once the local telephone companies have similarly modernized their facilities. NTN has called upon the BOCs to set a bold goal of universal digital service, for both business and residential customers. We urge the Committee to join us in that call, so that the nation's telecommunications network will be fully prepared to meet the challenges of the information age.

In conclusion, this Committee has a vital role to play in guiding Congress's understanding and oversight of the issues associated with the AT&T Consent Decree. Among other actions, we hope you will convey this message to your colleagues: the interLATA restriction today remains vital to the preservation and development of the competition in the long distance industry.

Thank you again for this opportunity to present NTN's views.